

**Report to the 78th
Texas Legislature**

***Scope of Competition
in Telecommunications
Markets of Texas***

***Public Utility Commission of Texas
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Executive Summary

In the Report to the 77th Texas Legislature on the *Scope of Competition in the Telecommunications Markets*, the Public Utility Commission (Commission) reported that competitive local exchange carriers (CLECs) “now have the regulatory framework to challenge Southwestern Bell and Verizon for market share in Texas.” At the time of the *2001 Scope Report*, CLECs had captured 12% of the local telecommunications market in Texas. In the intervening time period, CLECs have gained an additional three percent market share. In roughly the same time period, Southwestern Bell Telephone Company (SWBT) has captured over 30% of the long-distance market in the areas where Southwestern Bell Corporation (SBC) has the authority to provide long-distance service.

Pursuant to Public Utility Regulatory Act (PURA) Section 52.006(a), the Commission submits this Report to the 78th Texas Legislature, *Scope of Competition in Telecommunications Markets in Texas*. This Report examines the existing condition of competition in the local, long-distance, and broadband telecommunications markets at both the national and state level. Over the past several years, the Texas Legislature, Congress, and the Commission have successfully laid the groundwork for competitors to enter the local telecommunications market. In the *2001 Scope Report*, the Commission reported that competitive providers were capturing more customers in the larger metropolitan and suburban areas of Austin, Dallas, Houston, and San Antonio, but the Commission noted that competition in rural areas was very limited. That situation is changing. As of June 2002, Texas CLECs serve 16% of the local customers in rural areas, 13% in suburban areas, and 16% in urban areas. In the *2001 Scope Report*, the Commission also reported that competitive providers were capturing more business customers than residential customers. The gap is narrowing in that area as well. CLECs currently serve 14% of residential customers and 17% of business customers, a difference of only three percent.

While the advent of competition in rural areas is a welcome sign, it is not clear that such competition is sustainable. The same can be said of the overall CLEC capture of customers in the Texas local market. This uncertainty is due partly to pending actions at the Federal Communications Commission (FCC) concerning the continuous availability of access to the incumbent local exchange carriers (ILECs’) networks. Even though ILECs have lost 15% of the access lines to competitors, they still serve 85% of the local market and own the underlying facilities. ILECs, therefore, may still possess market power. With regard to the wholesale provision of the incumbents’ network to competitive providers, any changes that minimize access to that network should be scrutinized carefully to avoid adding further uncertainty to the competitive market. With regard to the retail market, the Commission believes regulatory oversight of rates, quality of service, and other customer protections are critical elements to sustain a competitive landscape.

Since the *2001 Scope Report*, the Commission has continued to implement policies that foster a competitive local market. The Commission has also focused increased resources on customer protection and enforcement of cramming and slamming

and is preparing to file its first violation report under the 2001 No-Call list statute. These issues and others will be explored in depth in this Report.

Chapter I of this report reacquaints the reader with brief highlights of relevant state and federal statutes. Chapter II provides a summary of the financial and economic profile of the telecommunications industry on a national basis. The nationwide status of competition in local and broadband service markets contained in Chapter II provides a richer context and a broad discussion of the current trends in competition. This overview of national issues provides a context for the activities occurring in Texas as outlined in Chapter III. Chapter IV delineates the activities the Commission has taken over the last two years to further the evolution of competition in Texas, facilitate deployment in broadband, and embrace customer protections. Federal initiatives pending before Congress and stirring within the FCC will undoubtedly affect the current dynamics within the telecommunications industry in Texas and could significantly change the business plans and the business relationships among ILECs, CLECs, internet service providers (ISPs), and other related industry participants. Chapter V delineates some of the bills that gained significant discussion in Congress and highlights the prospective and profound FCC decisions that affect the aforementioned dynamics. Chapter VI describes the homeland security initiatives that are occurring at both the federal and state levels to ensure the preparation of the telecommunications infrastructure in the event of an emergency, and provides a synopsis of the Commission's involvement in these activities. Chapter VII highlights some of the emerging issues in the telecommunications market, and provides an analysis of the debate surrounding these issues. The Report concludes with a legislative recommendation for the Legislature's consideration in the 78th legislative session.

Chapter I. Legislative Parameters for Local Telephone Competition

To provide a backdrop for this Report, following is a brief overview of key legislation related to telecommunications that was enacted in prior sessions, as well as highlights of the Federal Telecommunications Act of 1996 (FTA).¹

A. Key Legislation

1. Texas House Bill 2128

In 1995, the Texas Legislature adopted House Bill (H.B.) 2128, which significantly amended the Public Utility Regulatory Act (PURA) with regard to telecommunications. It mandated the opening of local exchange telecommunications markets in Texas, particularly in areas served by Southwestern Bell Telephone Company (SWBT) and GTE Southwest Incorporated (now Verizon Southwest). The law provided a framework for competitive local exchange carriers (CLECs)² to obtain authority from the Commission to provide local exchange service through any of three avenues, including the building of network facilities,³ leasing local loops,⁴ or reselling another company's telecommunications services.⁵ Additionally, H.B. 2128 established the duty of telecommunications providers to "interconnect" their networks with each other.⁶

2. Federal Telecommunications Act of 1996

On February 8, 1996, Congress enacted the FTA, which paralleled H.B. 2128 in numerous ways, and fundamentally changed telecommunications markets for the entire nation. The FTA was the most dramatic change in telecommunications law since Congress passed the Communications Act of 1934. Three principal goals established by the 1996 Act were:

¹ Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (codified as amended in scattered sections of 15 and 47 U.S.C.), the Federal Telecommunications Act (FTA).

² Perspectives on CLEC market share in Texas are discussed in Chapter III of this Report.

³ TEX CIV. STATS. ANN. art 1446c-0 (*referred to as* PURA95) repealed by Act of May 12, 1995, 74th Leg., R.S., ch. 231, 1995 Tex. Gen. Laws 2017; and *repealed by* Act of May 8, 1997, 75th Leg., R.S., ch. 166 §9, 1997 Tex. Gen. Laws 1018. PURA95 § 3.2531 (repealed). The remaining part of this section is recodified in the Public Utility Regulatory Act (PURA), TEX. UTIL. CODE, Ch. 54, Subchapter C (Vernon 1998 & Supp. 2003).

⁴ PURA95 § 3.453, recodified as PURA Ch. 60, Subchapter C (Vernon 1998 & Supp. 2003). *In addition*, PURA95 § 3.453, recodified as PURA § 60.021 (Vernon 1998) directed ILECs to unbundle their networks to the extent ordered by the FCC.

⁵ PURA95 § 3.453 (repealed), recodified as PURA Ch. 60, Subchapter C (Vernon 1998 & Supp. 2003).

⁶ PURA95 § 3.458 (repealed), recodified as PURA Ch. 60, Subchapter G (Vernon 1998 & Supp. 2003).

1. opening the local markets to competitive entry;
2. promoting increased competition in telecommunications markets that were already open to competition, including the long-distance services market; and
3. reforming the system of universal service so that universal service would be preserved and advanced as the local exchange and exchange access markets moved from monopoly to competition.

3. Texas Senate Bill 560 and Senate Bill 86

In 1999, the Texas Legislature revised PURA by enacting two bills dealing with the provision of local exchange telephone service. Senate Bill (S.B.) 560 increased flexibility for ILECs in pricing and packaging telecommunications services. The Texas Legislature also passed S.B. 86 to ensure customer choices and protections.

B. Key Features of the FTA

1. The Trilogy: Local Competition, Universal Service, and Access Charges

The Federal Communications Commission (FCC) views the FTA as a trilogy, *i.e.* a three-pronged plan. The first prong of the trilogy consisted of opening local exchange and exchange access markets to competition.⁷ The FTA requires all local exchange carriers (LECs), not just incumbents, to interconnect so that competing carriers can provide service.⁸ The FTA also requires incumbents to provide CLECs with access to their networks. The second prong of the trilogy is universal service reform. Consistent with FTA Section 254, *Universal service*, the FCC believes the universal service support system must guarantee affordable telephone service to all Americans in an era in which competition will be the driving force in telecommunications. The third prong of the trilogy is access charge reform.⁹ Because a competitive market drives prices toward cost, the then-existing system of access charges was unsustainable because access charges were widely believed to be significantly higher than the cost of providing access.

2. Methods of Competitive Market Entry

Section 251(a)(1) of the FTA requires all telecommunications carriers to interconnect with the facilities and equipment of other telecommunications carriers, allowing competitors three ways to serve customers.

⁷ Opening local markets was accomplished primarily through the Federal Telecommunications Act of 1996 (FTA), 47 U.S.C.A. § 251 (West 2003), relating to *Interconnection*, and 47 U.S.C. § 252 (West 2003), relating to *Procedures for negotiation, arbitration, and approval of agreements*. Additionally, special provisions for opening local markets contained in 47 U.S.C.A. § 271 (West 2003), relating to *Bell operating company entry into interLATA services*, pertain only to Bell Operating Companies.

⁸ 47 U.S.C.A. § 251(a)(1) (West 2003).

⁹ Access charges are per-minute charges billed by LECs to long-distance companies for access to the local exchange network so that long-distance companies can originate and terminate long-distance calls.

a. Resale

Under this entry method, competitors have the option to purchase telecommunications services from another LEC at wholesale rates and resell those services to their own customers at retail rates.¹⁰ Although resale was initially a mode of entry, its use has been declining rapidly as an entry strategy. In the early years after passage of the FTA, competitors sometimes used resale as a transitional entry strategy while building a proprietary network over a period of months or years.

b. Access to Unbundled Network Elements

This entry method enables competitors to lease discrete parts of an incumbent local exchange company's (ILEC's) network— facilities and equipment that are used to provide telephone service—at cost-based rates. These leased parts of the ILEC network are referred to as “unbundled network elements” (UNEs). Competitors can combine leased UNEs with their own facilities and/or resold services or they can provide local service using entirely ILEC UNEs, which is referred to as the UNE Platform (UNE-P or UNEP).¹¹ If the CLEC leases the ILEC loops, but provides at least some of its own facilities (typically a switch), this is known as UNE – Loop (UNE-L). UNE prices are set by State commissions, including the Texas Commission, based on costs — specifically total element long-run incremental costs (TELRIC). Many competitors now use UNE-P as a transitional entry strategy to establish a presence in the market until they have the customer volume to justify investing in facilities.

c. Construction of New Facilities

A competitor may enter a local telephone market by building entirely new facilities. Under a full “facilities-based” method of entry, a competitor builds the entire network that it needs to serve customers, including the “last mile” or “local loop” — the connection to a customer's premise. Because telecommunications networks are capital-intensive, there are relatively few full facilities-based carriers compared to the number of resellers, UNE-based carriers, or carriers that offer their services using a combination of their own facilities and the ILECs' UNEs.

3. The Section 271 “Carrot”

Section 271 of the FTA allows a Bell Operating Company (BOC) to enter the long-distance market after the BOC proves that it has opened its local network to competition.¹²

¹⁰ All LECs are required to make their telecommunications services available for resale pursuant to 47 U.S.C.A. § 251(b)(1) (West 2003). However, only *incumbent* LECs are required, pursuant to 47 U.S.C.A. § 251(c)(4) (West 2003), to make their retail telecommunications services available for resale at a wholesale rate.

¹¹ NEWTON'S TELECOM DICTIONARY at 727 (17th ed. 2001) (UNE-P includes the loop from the incumbent's central office to the customer's home or business, the switch, transport, and any necessary cross connects.)

¹² 47 U.S.C. § 271.

BOCs were created in 1984 with the divestiture of AT&T, and were granted monopoly status to provide local service, subject to regulation by the States.¹³ At that time, BOCs were prohibited from competing in the interLATA long-distance market to prevent them from committing anti-competitive practices against long-distance providers.

After lengthy proceedings and negotiation at the state and federal levels, SBC/SWBT was granted Section 271 approval in Texas by the FCC in June 2000, and began providing long-distance service in Texas in July 2000.

4. Federal-State Shared Responsibility for Implementation

The FTA's blueprint for encouraging local competition placed great responsibility on the FCC and state commissions to implement the law.¹⁴ Only six months after adoption of the FTA, the FCC produced two comprehensive documents charting a course for implementation. Some of the FCC's interpretations were challenged in federal court, and many of the FCC's interpretations of FTA requirements were affirmed. If specific FCC findings were not affirmed, federal and state regulators adjusted through regulatory rule and other processes.¹⁵

Implementation of the FTA was and continues to be a phenomenal undertaking—the magnitude of which could not have been foreseen at the time the FTA was adopted.

¹³ In 1984, there were seven Regional BOCs.

¹⁴ Although the FCC establishes nationwide guidelines, state regulators play a major role in implementing key provisions of the FTA. For example, state commissions must approve or reject interconnection agreements, and they have primary responsibility for arbitrating and mediating such agreements if asked to do so by the negotiating parties. State regulators are also charged with developing and implementing cost-based prices for interconnection and UNEs.

¹⁵ In its initial Order implementing the local competition provisions of the FTA in August 1996, the FCC established rules to accomplish interconnection between incumbent and competitive carriers, allow competitors to collocate equipment in the incumbent's structures, establish which parts of the incumbent's network would be open to competitors, and set out which States would be able to establish rates for competitors' interconnection. After the FCC released its ruling, several parties, including some state regulators, challenged the decision in *Iowa Utilities Board v. FCC*, 120 F.3d 753, 795, 800, 819 (8th Cir. 1997) (vacating 47 C.F.R. §§51.601-51.611). The Eighth Circuit overturned many of the FCC's rules on the grounds that the FCC had exceeded its authority and misinterpreted the FTA. In *AT&T Corp. v. Iowa Utilities*, 525 U.S. 366 (1999), the U.S. Supreme Court issued a decision that noted that the FTA was vague in some respects, affirmed the FCC's rulemaking authority to implement the local competition provisions of the FTA, and upheld most of the FCC's rules. The case was remanded to the lower court for further proceedings consistent with the Supreme Court's decision. While court challenges raged on, state regulators and the FCC moved forward with the implementation of competition in local exchange markets.

Chapter II. Status of the National Telecommunications Industry

This Chapter broadly addresses the status of the telecommunications industry from a national perspective in order to provide context for the Texas-specific discussion in Chapter III. The telecommunications industry has been center stage in the financial turmoil currently affecting Wall Street and the corporate and accounting scandals that have emerged in the last year. While financial news has dominated the headlines, many trends indicate that the industry is undergoing a significant competitive transition that continues to revolutionize the provision of telecommunications services.

This Chapter provides an overview of how these trends have affected the economic conditions of the industry, by describing the local, broadband, long-distance and wireless markets, and by providing competitive data on those markets. From a combination of Commission-gathered data and information gathered from public sources, the following conclusions can be reached:

- 1) nationwide the competitive local exchange carriers' (CLECs') local market share is growing, but the rate of growth has slowed since October 2001;
- 2) the broadband market is growing rapidly, and broadband service can be provided via the traditional telephone network, cable, or wireless technology;
- 3) the traditional long-distance market faces intense competition as a result of Regional Bell Operating Company (RBOC) entry and wireless substitution; and
- 4) the wireless market has high demand.

A. Financial Markets and the Telecommunications Industry

There is no question that the telecommunications industry has been severely affected by turmoil in the financial markets and by the corporate and accounting scandals that have emerged in 2001.

The current telecom downturn is, in terms of money lost, one of the largest business crises in U.S. history, surpassing the dot-com crash of 2000-01, the savings and loan crisis of the 1980s, and even the collapse of the railroads in the 1890s.¹⁶ Worldwide, more than \$2 trillion in telecom stock value has been lost over the past two years.¹⁷

During his speech at the Goldman Sachs Communicopia XI Conference in October 2002, the Chairman of the Federal Communications Commission (FCC), Michael Powell, stated that "Corporate governance scandals, over-capacity, hyper-competition in some markets, a retrenchment of capital, continuing credit-rating

¹⁶ Kevin Maney, *Future not so bright for telecoms*, USA TODAY, July 15, 2002.

¹⁷ *Id.* (In comparison, the savings and loan crisis wiped out \$250 billion (in 2002 dollars) in value.

downgrades, continued cuts in work force and capital expenditures and bankruptcies sadly characterize the day.”¹⁸

Stakeholders, regulators, the investment community, and commentators disagree as to the cause of the downturn. Some point to faulty mergers and over-consolidation.¹⁹ Others lay the blame on a glut of fiber in the ground. Incumbent local exchange carriers (ILECs) blame CLECs, asserting poor management and faulty business plans, while CLECs cite the allegedly intransigent, anti-competitive behavior of the ILECs from whom the CLECs must gain access to the network. Still others point to reduced reciprocal compensation revenues.²⁰ Others state that it may simply be that the perfect confluence of events—capital expenditures outpacing revenues and net income, corporate misbehavior, the natural monopoly characteristics of the last mile of phone lines to the home, enthusiastic mergers and acquisitions—created the perfect storm.

Seemingly, all sectors of the market have been affected by the decline in the telecommunications market: (1) over 47 CLECs have filed for bankruptcy in the United States since 2000;²¹ (2) the value of the RBOCs’ stock has declined;²² (3) interexchange carriers are struggling financially; and (4) WorldCom stands accused of perpetrating the most expensive corporate fraud case in history.²³ The sixth largest cable company, Adelphia, filed for bankruptcy and the owners were arrested on fraud charges.²⁴

¹⁸ Remarks of Michael K. Powell, Chairman of the Federal Communications Commission, at the Goldman Sachs Communicopia XI Conference, New York, NY, October 2, 2002.

¹⁹ Jim Krane, *Once-Thriving Telecoms Felled by Faulty Mergers: Acquisition Mentality, Changing Technology Aided Decline*, ASSOCIATED PRESS (May 5, 2002).

²⁰ *Shrinking Intercarrier Compensation Continues to Hurt Time Warner Telecom*, TR DAILY (May 8, 2002). (Reciprocal compensation involves arrangements between carriers for the transport and termination of telecommunications traffic. The originating carrier typically pays the terminating carrier for completing the call. Reciprocal compensation is the program by which the company doing the billing and collecting the money pays over some of those monies to the other phone companies in the chain.)

²¹ ALTS, *Progress Report on the CLEC Industry* at Appendix A (Oct. 17, 2002).

²² Sanford Nowlin, *SBC stock drops after layoff news: Analysts say firm is struggling because sales aren’t growing*, EXPRESS-NEWS at D1 (Sept. 28, 2002); ASSOCIATED PRESS, Web Posted: 12/05/2002 7:16 AM.

²³ Simon Romero and Riva Atlas, *WorldCom Files For Bankruptcy; Largest U.S. Case: Market is Expected to Reverberate after \$107 Billion Collapse*, NEW YORK TIMES at A1 (July 22, 2002).

²⁴ *Cable TV Giant Adelphia Files For Bankruptcy*, HC at 2B, (June 21, 2002). The fallout has also spread to telecommunications equipment manufacturers and vendors. Corning, the industry’s largest fiber-optic manufacturer, reported revenues in the first quarter 2002 that were half of what it earned in the first quarter of 2001. Dennis Berman and David Pringle, *Telecom-Equipment Earnings Fall: Declines at Large Firms Viewed as Sign That Crash of the Sector is Deepening*, WALL STREET JOURNAL at A3 (April 23, 2002). Corvis, a major fiber optic backbone provider for interexchange carriers, saw its revenue decline 90 percent from the prior year. Yuki Noguchi, *Corvis Revenue Drops Almost 90%: Lack of Demand in Telecommunications Brings Quarter Loss of \$71 Million*, WASHINGTON POST at E05 (April 26, 2002); see also *Corvis Corporation Reports Financial Results for the Second Quarter: Continued Focus on Streamlining Business to Meet Current Market Conditions*, www.corvis.com (July 25, 2002). Independent suppliers of last-mile fiber, such as MFN, Espire, Telergy and DTI, have all filed for bankruptcy protection. Dan Sweeney, *Did MFN Bury Fiber in all the Wrong Places?*, AMERICAN’S

Appendices B through E provide further explanation of external factors and trends that have affected the economics of the telecommunications industry in the United States, such as capital markets, bankruptcies, layoffs and capital expenditures, and consolidation.

1. Capital Markets

Since the peak in March 2000, telecom stocks, as measured by the American Stock Exchange index of 16 North American companies, have fallen more than 74%.²⁵ For further detail, please see Appendix B.

2. Bankruptcies

In speaking before the Senate Commerce Committee on July 30, 2002, FCC Chairman Powell commented that the telecom industry collectively owes a trillion dollars, “much of which will never be repaid and will have to be written off by investors.”²⁶ Appendix C contains more detailed information on these bankruptcies.

3. Layoffs and Capital Expenditures

The job market in Texas has been affected by the industry’s national decline: since the beginning of 2002, Southwestern Bell Corporation (SBC) and Alcatel (among others) have announced that thousands of workers in the State will be laid off.²⁷ Appendix D contains in-depth further information regarding these layoffs and reduced capital expenditures.

4. Consolidation

Upon divestiture in 1984, the Bell System was divided into seven local service providers, also known as the RBOCs, and one company to house the long-distance company (AT&T) and equipment manufacturing arm (which has subsequently spun off as Lucent in 1996). By 2002, just six years after the Federal Telecommunications Act (FTA), only four RBOCs—Verizon, BellSouth, SBC, and Qwest—remain, having bought out or merged with the other three, as well as with GTE. Appendix E contains more detailed information on consolidations.

B. Telecommunications Industry Trends

While the telecommunications industry has been affected by Wall Street’s financial crisis, the industry continues toward a significant competitive transition. Local

NETWORK WEEKLY (May 24, 2002). Equipment manufacturers Lucent and Ericsson have reported massive losses, and both have cut their workforce to control expenses. Vikas Bajaj, *Telecom Is Still Melting Down: Ericsson, Lucent Join Industry List of Firms Facing Tough Times*, DALLAS MORNING NEWS at D1 (April 23, 2002).

²⁵ Michael A. Hiltzik and James F. Peltz, *Did Telecom Reformers Dial the Wrong Number?*, LOS ANGELES TIMES, July 24, 2002.

²⁶ Paul Starr, *The Great Telecom Implosion*, THE AMERICAN PROSPECT, September 9, 2002, available at <http://www.prospect.org/print/V13/16/starr-p.html/>.

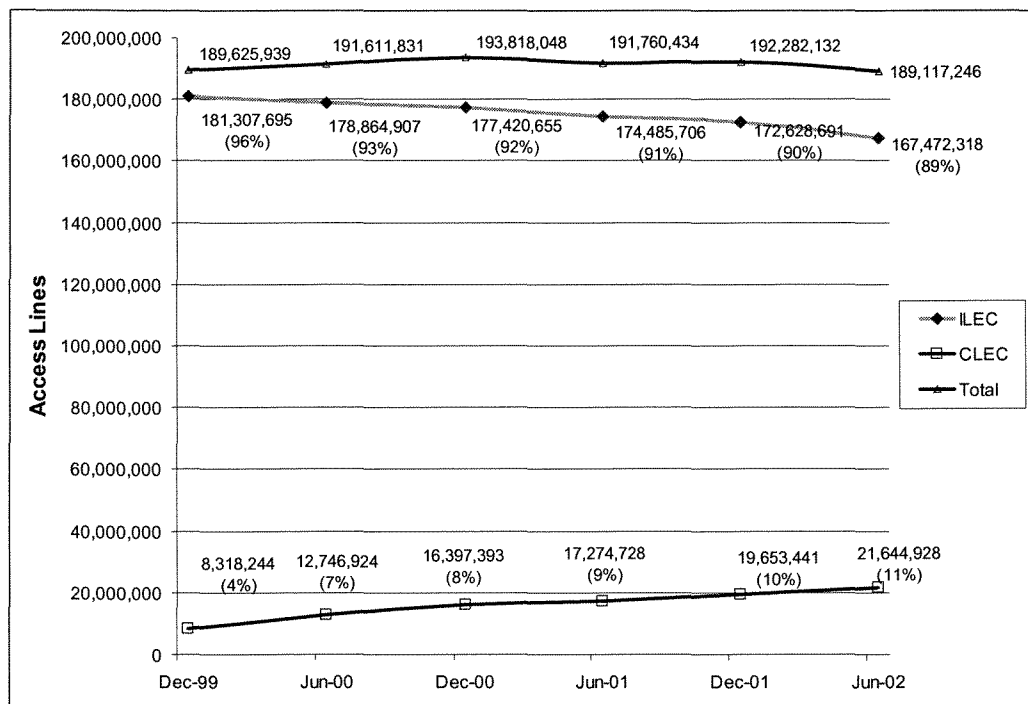
²⁷ Vikas Bajaj, *Texas’ SBC, Alcatel Shedding More Jobs*, DALLAS MORNING NEWS at 1-A (May 12, 2002).

telecommunications competition continues but at a slower rate of growth. Wireless demand remains high and some consumers have begun to substitute wireless phones for traditional landline phones. Consumers have benefited significantly from strong competition in the long-distance market. Broadband internet demand has also grown. Taken together, these trends indicate that the telecommunications industry is undergoing significant competitive transition that will bring more choices to consumers.

1. Local Telephone Competition

As shown in Figure 1, as of June 2002, the total number of access lines reached a peak in December of 2000, declined in June of 2001, increased again in December of 2001 and decreased again as of June 2002. During the same period, the CLECs' share of those access lines has increased, while the ILECs' share has decreased. As of June 2002, CLECs had approximately 21.6 million local lines nationwide, representing 11% of the total market.

Figure 1 — Nationwide Growth of Access Lines



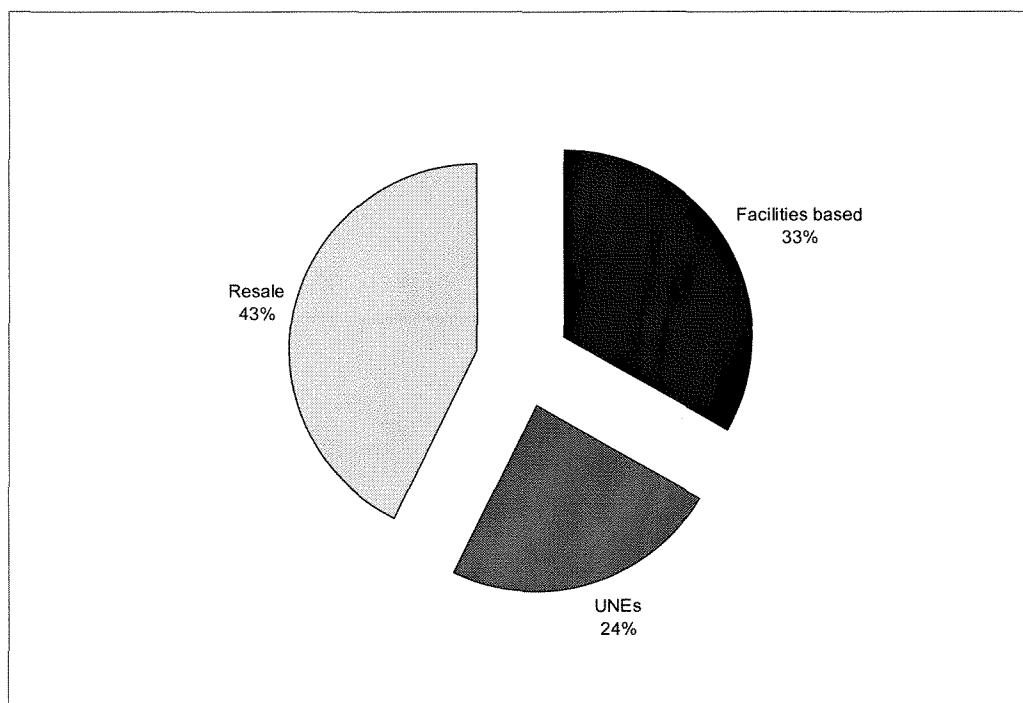
SOURCE: *Local Telephone Competition Reports*, FCC (Aug. 2000, May 2001, July 2002, Dec. 2002).

CLECs may enter the local market by (1) purchasing the ILEC's retail service and reselling that service to the CLEC's own end-use customers, (2) building their own facilities, or (3) purchasing unbundled network elements from the ILEC, and using those elements, either alone or in conjunction with their own facilities, to provide service to their end-use customers.²⁸

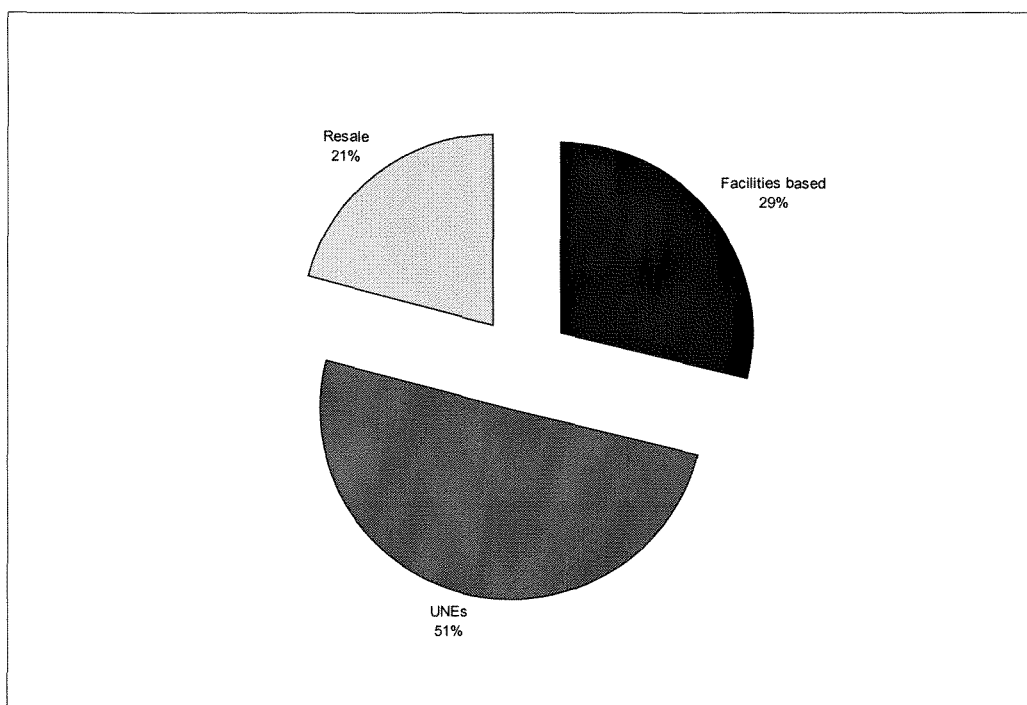
²⁸ Please see Appendix I for a detailed explanation of CLEC entry strategies.

As shown in Figures 2 and 3, the CLECs' primary entry vehicle has changed from total service resale in December 1999 to use of unbundled network elements (UNEs) in June 2002.

Figure 2 — CLEC National Entry Strategy by Access Line, as of December 1999



SOURCE: FCC, *Local Telephone Competition Report at Table 3* (July 2002).

Figure 3 — CLEC National Entry Strategy as of June 2002

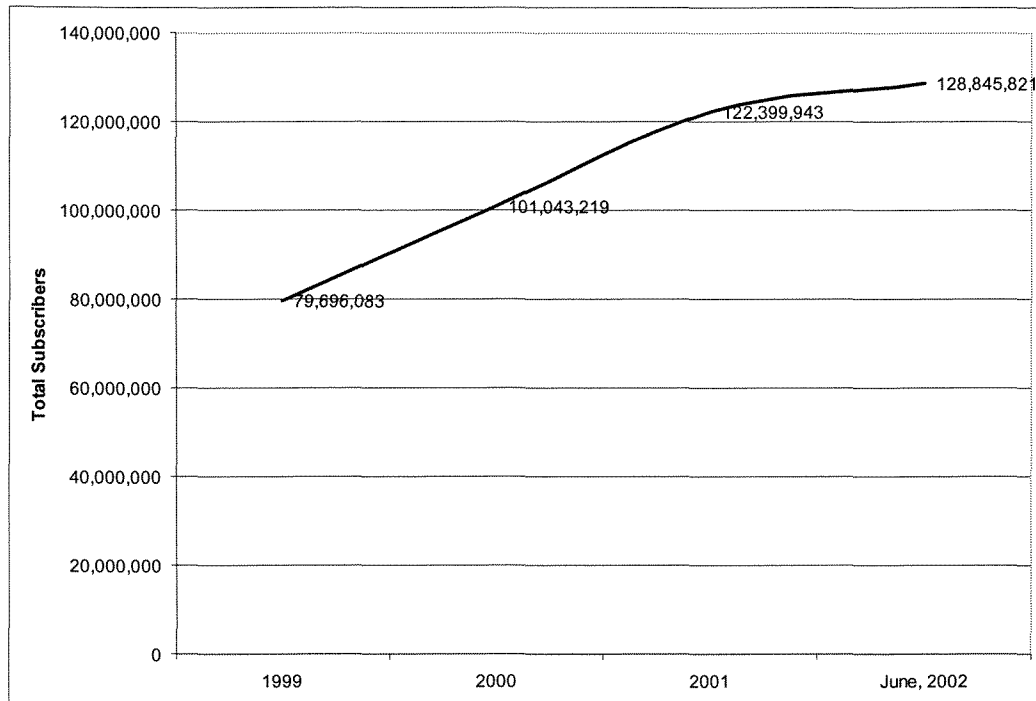
SOURCE: FCC, *Local Telephone Competition Report at Table 3* (Dec. 2002).

Many of the RBOCs are attempting to remove their obligations to provide CLECs with access to UNEs, as described more fully in Chapters III-V.

2. Wireless Market

Demand for wireless phones remains relatively high and continues to grow. As shown in Figure 4, the number of mobile wireless subscribers at the national level has increased 65% since 1999.

Figure 4— Wireless Subscribers by Year



SOURCE: *Local Telephone Competition Reports*, FCC (Aug. 2000, May 2001, July 2002, Dec. 2002).

The price for wireless phone service has dropped by 30% between December 1997 and June 2001.²⁹ The average wireless customer paid only 5% more in 2001 than in 2000 for service, but used that service 50% more.³⁰

3. Long-Distance Market

The long-distance market has probably been most heavily influenced by the competitive transition. Competition has increased as the RBOCs have received authority to enter the market. The long-distance service offered as part of many wireless phone plans allows consumers to substitute wireless service for traditional long-distance usage. In addition, “instant messaging” and even email are affecting long-distance.

²⁹ Shelley Emling, *Telecom pain: No long-distance gain*, AUSTIN AMERICAN-STATESMAN, June 28, 2002, p. 1C.

³⁰ *Bad Connection*, FORBES, August 12, 2002, p. 85.

In July of 2000, SBC entered the Texas long-distance market after its grant of Section 271 authority. In February of 2001, SBC also entered the long-distance markets in Kansas and Oklahoma. In December of that year, SBC entered the long-distance markets in Arkansas and Missouri. Although SBC has been in the long-distance market for a relatively short period, SBC states that it has 5.9 million customers in the six states where it provides long-distance service, out of a total of 19 million access lines. SBC's share of the long-distance market in those six States is, therefore, over 30%.³¹ In January of 2002, less than two years after SBC had been granted the authority to provide long-distance in Texas, and less than one year after SBC's entry into Kansas and Oklahoma, SBC estimated that it served over 35% of long-distance consumers in those three States.³² In December 2002, SBC was granted Section 271 authority in California: "with the launch in California, SBC will be in a position to provide long-distance service to approximately two-thirds of its local lines."³³

Other RBOCs have experienced rapid growth in the long-distance market as well. For instance, Verizon has captured approximately 30% of the long-distance market in New York and Massachusetts.³⁴ In New Jersey and Maine, Verizon gained 9% of the consumer market within three months of introducing long-distance service. Contrast these numbers with CLEC penetration in the local market; it took CLECs almost six years in the local market to gain a 10% share. As of December 2002, Section 271 approvals have been granted in 35 states and there are pending applications for an additional three states. RBOC entry into the long-distance market should therefore continue to gain momentum over the coming years.

As noted above, wireless phone plans may offer low-cost long-distance, which can substitute for traditional long-distance usage. According to Forrester Research, wireless companies will take as much as \$3 billion in revenue away from long-distance companies by 2006, while costing local carriers \$8.8 million in that same time.³⁵

Between December 1997 and June 2001, the price for wireless phone service dropped more than 30% per minute, while the long-distance charges related to traditional wireline phone service dropped more than 10% and the price of local phone service rose 12%.³⁶ In an effort to combat the loss of long-distance minutes from wireless usage and to respond to the long-distance plans offered by SBC and other RBOCs, many traditional long-distance providers are offering packages that include unlimited long-distance for a fixed rate.³⁷ Some long-distance companies have tried to offset high costs by adding

³¹ Southwestern Bell Corporation, SBC INVESTOR BRIEFING (October 24, 2002) at 5.

³² Southwestern Bell Corporation, SBC INVESTOR BRIEFING (January 24, 2002) at 7.

³³ *Id.* at 6.

³⁴ VERIZON INVESTOR QUARTERLY (October 25, 2002) at 5.

³⁵ Shelley Emling, *Telecom pain: No long-distance gain*, AUSTIN AMERICAN-STATESMAN, June 28, 2002, p. 1C.

³⁶ *Id.*

³⁷ Ryan Chittum, *Phone Service On the Cheap*, WALL STREET JOURNAL, July 2, 2002, p. D1.

monthly fees to long-distance. MCI WorldCom, Sprint, and AT&T have all added fees of \$1.95-\$1.99 to the price of their long-distance services, presumably to cover the costs of in-state access charges (about \$0.057 per minute in Southwestern Bell Telephone (SWBT) areas in Texas).³⁸ Further information on the long-distance market, pertaining specifically to AT&T, WorldCom, and Sprint, may be found in Appendix F.

4. Broadband Deployment

“Broadband” is a term used to describe high-speed access to the internet. Modes of broadband include digital subscriber line (DSL) service provided by phone companies over telephone lines; high-speed access via cable typically provided by cable television providers; and satellite and wireless service. As illustrated in Tables 1 and 2, the number of broadband users nationwide has steadily increased since 1999, more than tripling in the last two years.

Table 1 — Number of Broadband Users Nationwide (1999-2002)

| Broadband Technology | Dec. 1999 | June 2000 | Dec. 2000 | June 2001 | Dec. 2001 | June 2002 |
|---|------------------|------------------|------------------|------------------|-------------------|-------------------|
| Cable Modem | 1,411,977 | 2,284,491 | 3,582,874 | 5,184,141 | 7,059,598 | 9,172,895 |
| Asymmetric Digital Subscriber Line (ADSL) | 369,792 | 951,583 | 1,977,101 | 2,693,834 | 3,947,808 | 5,101,493 |
| Other Wireline | 609,909 | 758,594 | 1,021,291 | 1,088,066 | 1,078,597 | 1,186,680 |
| Fiber | 312,204 | 307,151 | 376,203 | 455,593 | 494,199 | 520,884 |
| Sat./Fixed Wireless | 50,404 | 65,615 | 112,405 | 194,707 | 212,610 | 220,588 |
| Total | 2,754,286 | 4,367,434 | 7,069,874 | 9,616,341 | 12,792,812 | 16,202,540 |

SOURCE: *High-Speed Services for Internet Access: Subscribership as of December 2001*, FCC (Dec. 2002).

Table 2 — Growth of Broadband Users Nationwide (1999-2002)

| Broadband Technology | % Growth Dec. 1999 – June 2001 | % Growth June 2000 – Dec. 1999 | % Growth Dec. 2000 – June 2001 | % Growth June 2001 – Dec. 2001 | % Growth Dec. 2001 – June 2002 |
|----------------------|--------------------------------|--------------------------------|--------------------------------|--------------------------------|--------------------------------|
| Cable Modem | 62% | 57% | 45% | 36% | 30% |
| ADSL | 157% | 108% | 36% | 47% | 29% |
| Other Wireline | 24% | 35% | 7% | -1% | 10% |
| Fiber | -1.6% | 23% | 21% | 8% | 5% |
| Sat./Fixed Wireless | 30% | 71% | 73% | 9% | 4% |
| Total | 59% | 62% | 36% | 33% | 27% |

SOURCE: *High-Speed Services for Internet Access: Subscribership as of December 2001*, FCC (Dec. 2002).

³⁸ Vikas Bijaj, *MCI to add long-distance fee in Texas*, DALLAS MORNING NEWS, August 6, 2002, p. D6.

As shown in Tables 1 and 2, the FCC reports that broadband nationwide usage increased by 27% during the first half of 2002, from 12.8 million to 16.2 million lines, compared to a 33% increase, from nearly 9.6 million to 12.8 million lines, during the first half of 2001. Of the 16.2 million high-speed lines, residential and small business subscribers grew 27% from 11 to almost 14 million users reported six months earlier.

DSL lines increased by 29% during the first half of 2002, from nearly 3.9 million to over 5.1 million lines, compared to a 47% increase, from 2.7 million to 3.9 million lines, during the preceding six months.³⁹ Cable modem service increased by 30% during the first six months of 2002, from 7 million to 9.1 million lines.⁴⁰ By comparison, cable modem service increased by 36%, from nearly 5.2 million to 7.1 million lines, during the last half of 2001.⁴¹

SBC reported an increase in broadband subscribers of 14% in the second quarter of 2002.⁴² BellSouth signed up 74,000 DSL customers in the second quarter of 2002 for a total of 800,000 DSL customers.⁴³ AT&T also reported growth in broadband (most of which is cable) in the second quarter of 2002.⁴⁴ The internet research firm Nielsen/NetRatings reported in March 2002 that the amount of time spent online by broadband users has surpassed the amount of time spent online by dial-up users in January 2002. The firm also reported that the total amount of time spent online by broadband users had risen 64% between January 2001 and January 2002.⁴⁵

³⁹ *High-Speed Services for Internet Access, Status as of June 30, 2002*, Federal Communications Commission, Industry Analysis and Technology Division, Wireline Competition Bureau, December 2002. Available online at: www.fcc.gov/wcb/iatd/comp.html.

⁴⁰ *Id.*

⁴¹ *Id.*

⁴² SBC Communications reports lower earnings for 2nd quarter, ASSOCIATED PRESS, July 23, 2002.

⁴³ Seth Schiesel with Simon Romero, *Regional Bell Giants No Longer Invulnerable*, NEW YORK TIMES, July 23, 2002, sec. C, p. 6.

⁴⁴ Bruce Meyerson, *AT&T Posts \$12.7 Billion Loss*, ASSOCIATED PRESS, July 23, 2002.

⁴⁵ *Broadband Usage Surpasses Dial-Up*, LOS ANGELES TIMES, March 6, 2002.

Chapter III. Status of the Texas Telecommunications Industry

In June 2000, Southwestern Bell Telephone (SWBT) was granted approval by the Federal Communications Commission (FCC) to enter the long-distance market in Texas. As determined by the Commission and the FCC during SWBT's Section 271 approval process, SWBT had met the statutory requirements to open its local markets to competition.⁴⁶ SWBT entered the long-distance market in July 2000. Two years later, Southwestern Bell Corporation (SBC) has made significant progress in the long-distance market while competition in the local market is still emerging, and many competitors of SWBT are struggling to remain financially viable. As competition in the telecommunications market continues to take hold in Texas, several issues and matters have been brought to the forefront for the Commission's consideration.

Chapter III examines competitive issues relating to the local service market in Texas. The discussion begins with an assessment of the data regarding the overall industry revenue and market share for incumbent local exchange carriers (ILECs) and competitive local exchange carriers (CLECs) in Texas. The discussion then turns to how ILECs and CLECs compete in the marketplace. This analysis includes a discussion of the CLECs' methods of entry and geographic market.

Additionally, the Chapter examines competitive issues relating to the long-distance market, including the disparity between intrastate and interstate access rates and the pass-through of access rate reductions by long-distance carriers. The Chapter ends with a look at competitive issues relating to broadband.

A. Local Telephone Market in Texas

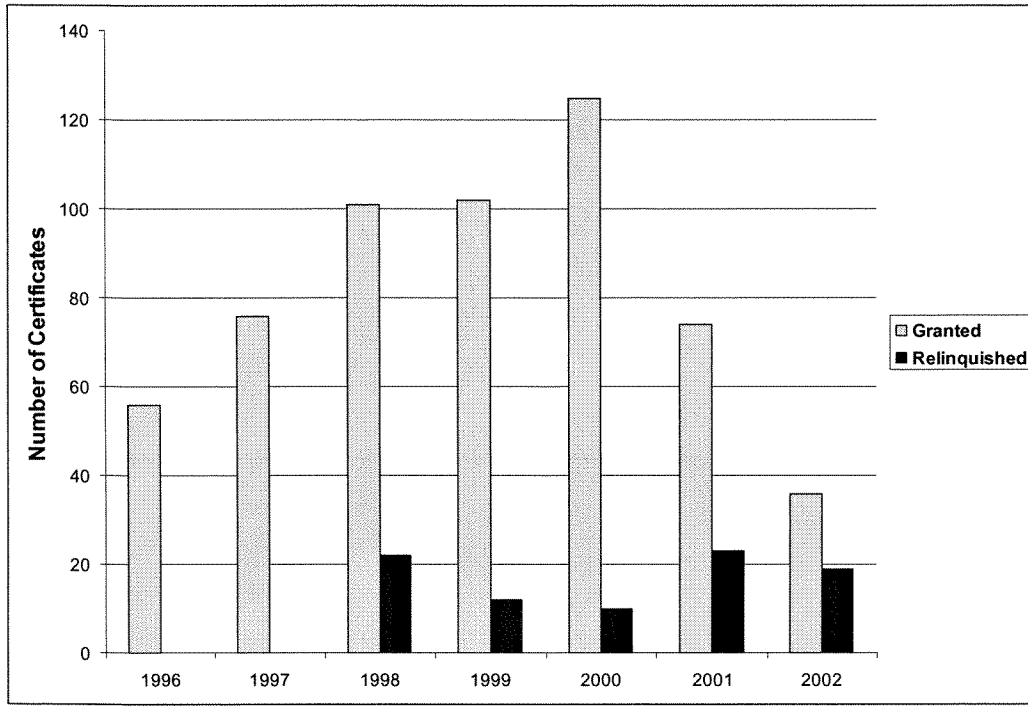
1. Texas CLEC Certifications

From the passage of the FTA until 1999, Texas saw a huge influx of CLECs seeking to serve markets throughout the State. Under the Public Utility Regulatory Act (PURA) § 54.001, a CLEC must have a certificate issued by the Commission to operate and provide telecommunications service in Texas.⁴⁷ As illustrated by Figure 5, the number of service provider certificates of operating authority (SPCOAs) and certificates of operating authority (COAs) applied for and granted annually has declined steadily since 2000. For the year 2001, the Commission awarded 73 SPCOAs and 1 COA; and as of October 23, 2002, the Commission had awarded 34 SPCOAs and 2 COAs. This represents a noticeable decline from the year 2000 when 106 SPCOAs and 6 COAs were awarded. In addition, the number of SPCOAs and COAs relinquished by CLECs has increased from 10 in 2000 to 23 and 19 in 2001 and 2002, respectively.

⁴⁶ *Application by SBC Communications Inc, Southwestern Bell Telephone Company, and Southwestern Bell Communications Services, Inc. d/b/a Southwestern Bell Long Distance Pursuant to Section 271 of the Telecommunications Act of 1996 to Provide In-Region, InterLATA Services in Texas*, CC Docket 00-65, Memorandum Opinion and Order, at 395 (rel. June 30, 2000).

⁴⁷ PURA § 54.001 (Vernon 1998 & Supp. 2003).

**Figure 5 — Number of SPCOAs and COAs Certifications
Granted and Relinquished in Texas, by Year**



SOURCE: PUC filings

As shown in Table 3, there are 490 CLECs certified to operate in Texas. Of the 554 certificated telecommunications utilities in Texas, 202 submitted data responses to this year's scope of competition data request, 138 of them CLECs, compared to 128 CLECs in 2000.⁴⁸ In addition, 76 CLECs filed letters stating that they did not provide services in Texas during the requested time period.⁴⁹

Table 3 — Number of Texas CLECs

| | 1996 | 1998 | 2000 | 2002 |
|--|------|------|------|------|
| Approx. Number of Certificated CLECs | 70 | 200 | 432 | 490 |
| Approx. Number of CLECs filing Data Responses | n/a | 50 | 128 | 138 |

SOURCES: *Report to the Seventy-Fifth Legislature on the Scope of Competition in Telecommunications Markets* at 2 (January 1997), *Report to the Seventy-Sixth Legislature on the Scope of Competition in Telecommunications Markets* at 55, 92 (January 1999), *Report to the Seventy-Seventh Legislature on the Scope of Competition in Telecommunications Markets* at 37 (January 2001); Texas PUC 2003 Scope of Competition Data Responses.

This decline in the number of CLECs in Texas is consistent with trends at the national level. The number of CLECs in Texas declaring bankruptcy and discontinuing services has steadily increased; between 1999 and 2002, 47 CLECs declared bankruptcy. Seven of those went into Chapter 7 bankruptcy, which resulted in the liquidation of the company's assets. A complete list of all carriers with operations in Texas that have filed for bankruptcy is available in Appendix G.

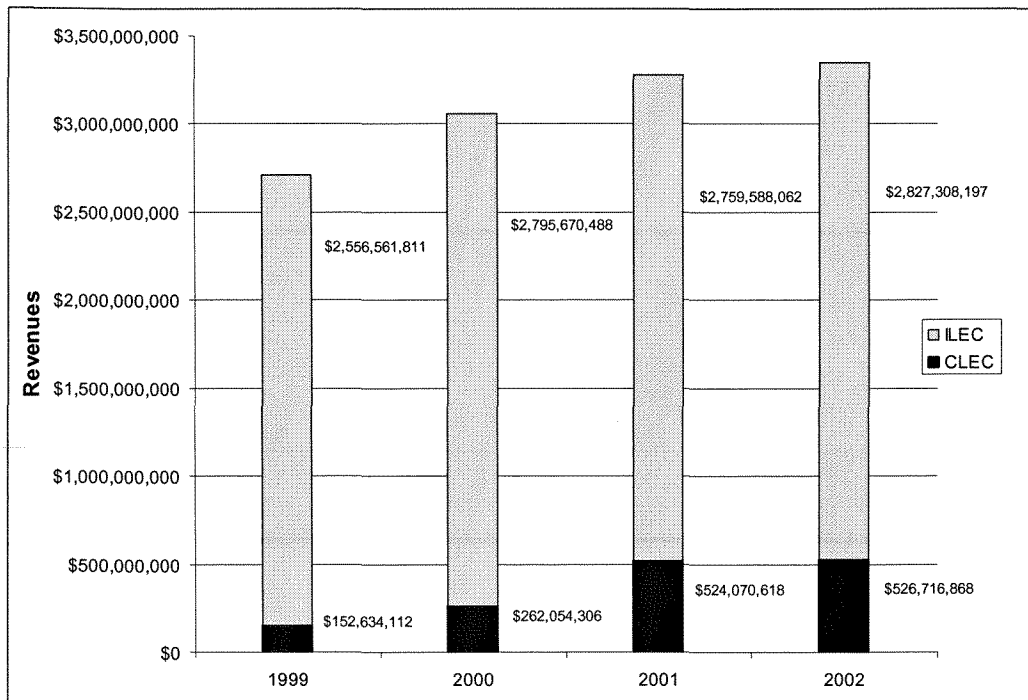
⁴⁸ The data compiled for this year's scope report includes self-reported data from 202 ILECs and CLECs. The Commission estimates that this represents at least 95% of the access lines served in Texas.

⁴⁹ It is important to note that the number of SPCOAs and COAs overstates the actual number of entrants into the market. While the Commission has certified many carriers to provide service, some have yet to offer any service to the public. A carrier who does not have any customers to date is only a potential competitor. In addition, some carriers with certificates no longer provide service.

2. Overall Industry Revenues and Market Share

After three years of rapid growth, CLEC revenues and access lines ceased to grow in 2002. As shown in Figure 6, CLEC revenues from basic dial-tone service in Texas have also flattened out to approximately \$527 million in June 2002, compared to \$2.8 billion for the ILECs.

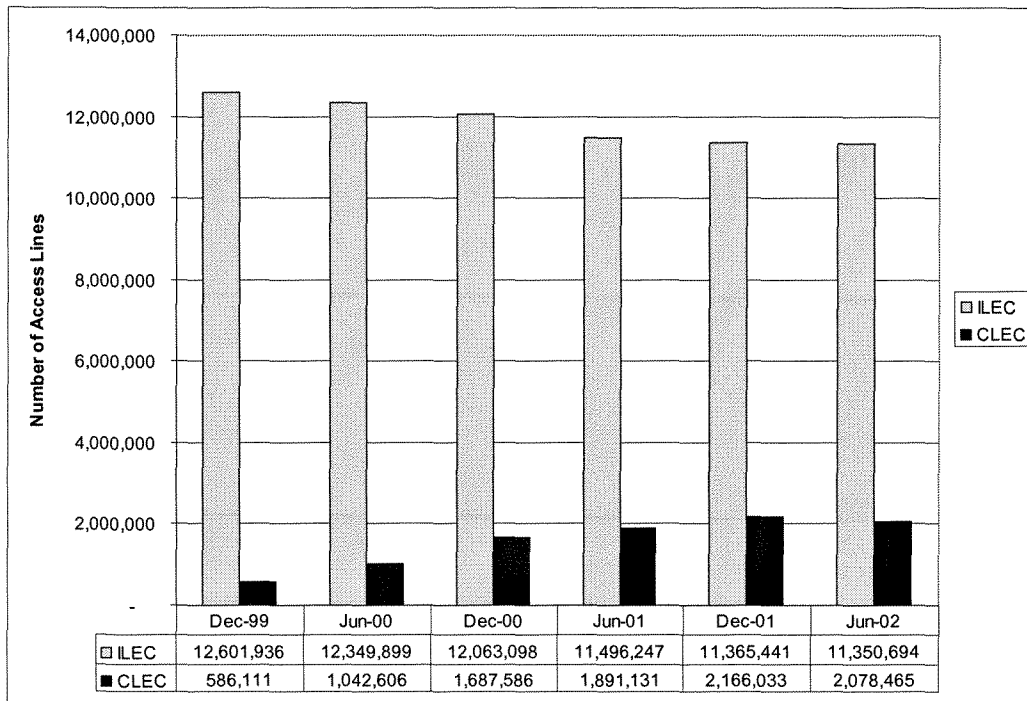
Figure 6 — ILEC vs. CLEC Basic Local Service Revenues in Texas



SOURCE: Texas PUC 2003 Scope of Competition Data Responses. The June 2002 revenue as reported has been doubled to estimate year-end 2002 revenues.

From December 2001 to June 2002, the number of ILEC lines decreased from 11,365,441 to 11,350,694, while the total number of CLEC lines decreased from 2,166,033 to 2,078,465 during that same period.⁵⁰ This represents a decrease of CLEC market share from 16% to 15% during that same period and a corresponding increase in ILEC market share from 84% to 85%, despite the overall decrease in ILEC lines.

Figure 7 — ILEC vs. CLEC Lines in Texas



SOURCES: *Local Telephone Competition Reports*, FCC (Aug. 2000, May 2001, July 2002), Texas PUC 2003 Scope of Competition Data Responses.

The rate of overall CLEC market-share growth, which measures the momentum of competitors in the local exchange market, has shown a sharp downward trend over the last two-year period.

Table 4 — CLEC Market Share and Growth Rates in Texas

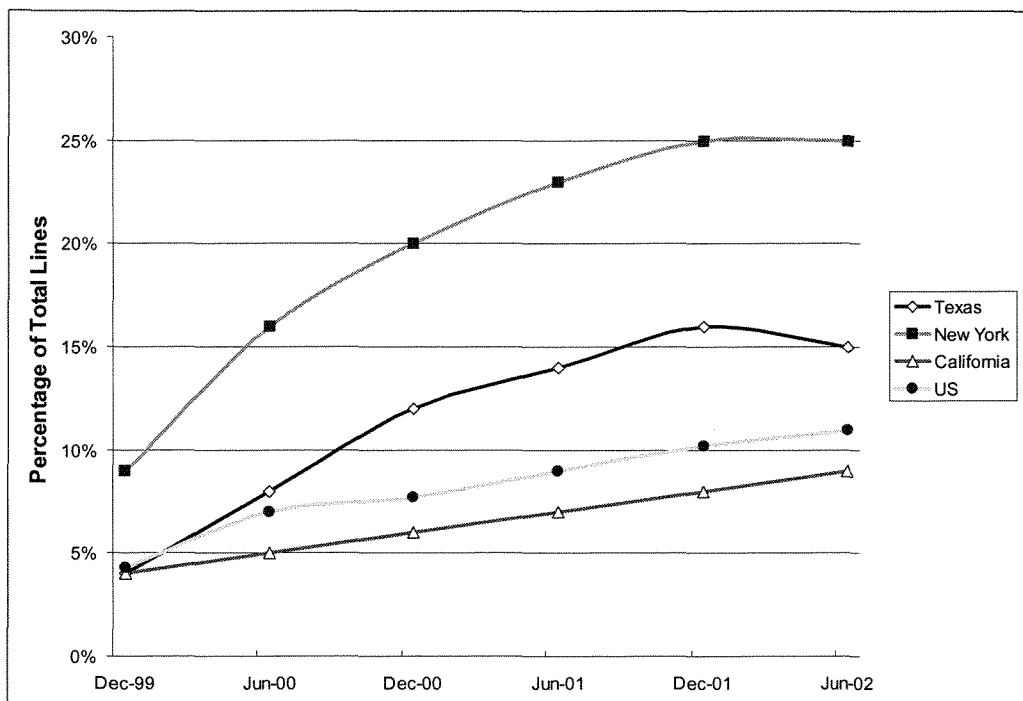
| | Dec. 1999 | June 2000 | Dec. 2000 | June 2001 | Dec. 2001 | June 2002 |
|---------------------|-----------|-----------|-----------|-----------|-----------|-----------|
| Market Share | 4% | 8% | 12% | 14% | 16% | 15% |
| Growth Rate | — | 75% | 58% | 15% | 13% | -3% |

SOURCES: *Local Telephone Competition Reports*, FCC (Aug. 2000, May 2001, July 2002), Texas PUC 2003 Scope of Competition Data Responses.

⁵⁰ For additional data regarding ILEC and CLEC Retail lines in Texas from December 1999 to June 2002, please see Appendix H.

To put the data in a national context, CLEC line growth in Texas (approximately 15% at the end of June 2002) was higher than both the national average (approximately 11%) and the CLEC share in California (approximately 9%). As shown in Figure 8, CLECs in New York, the first state to gain Section 271 approval in 1999, had 25% of the lines.

Figure 8 — CLEC Line Growth in Texas Compared with Nationwide and Other States



SOURCES: *Local Telephone Competition Reports*, FCC (Aug. 2000, May 2001, July 2002, Dec. 2002), Texas PUC 2003 Scope of Competition Data Responses. The FCC reported 2,170,914 CLEC access lines in Texas as of June 2002, which is 92,449 more lines than CLECs reported to the Texas PUC for the same reporting period.

3. CLEC Business Strategies

a. CLEC Modes of Entry

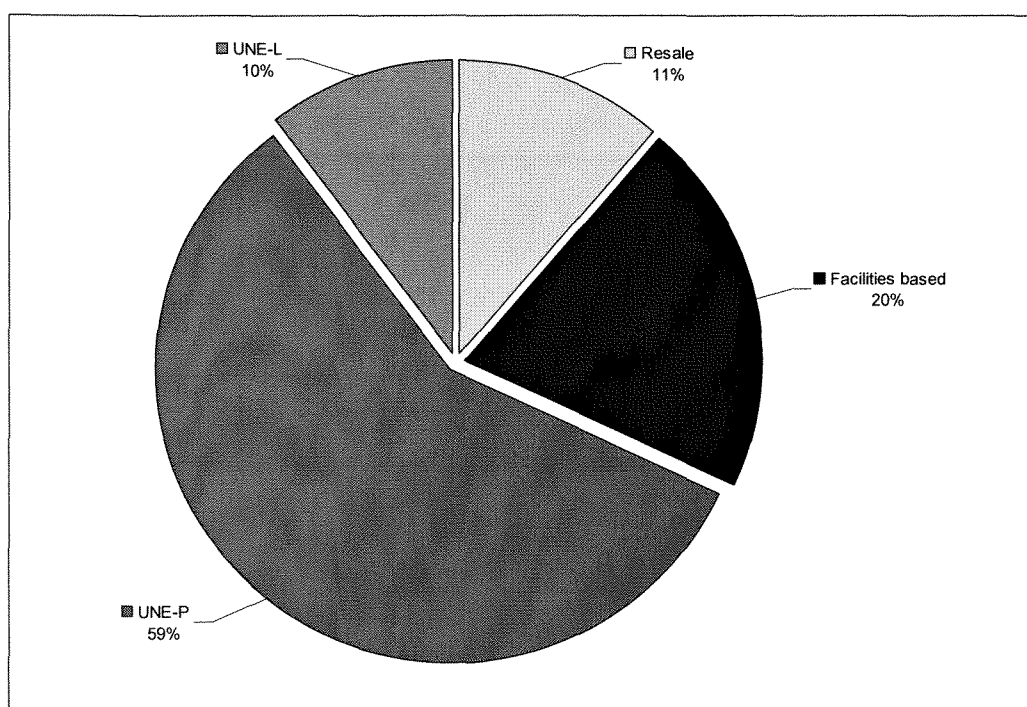
As explained in Chapter II of this Report, Section 251 of the Federal Telecommunications Act (FTA) envisioned three basic modes of entry by CLECs:⁵¹ (1) facilities-based; (2) unbundled network elements (UNEs);⁵² and (3) resale.

⁵¹ Please see Appendix I for a detailed explanation of CLEC entry strategies.

⁵² The leasing of UNEs typically occurs in one of two fashions, via UNEs (also known as UNE-Loop or UNE-L, which is the lease of one or more of the network components required for the provision of a telecommunications service), or UNE-Platform (UNE-P, which is the lease of a complete set of network elements that allows the provision of an end-to-end circuit). Individual or combinations of UNEs are available pursuant to the parties' relevant interconnection agreement, such as the Texas 271 Agreements (T2A).

As illustrated by Figure 9, Texas CLECs serve customers primarily through unbundled network element platform (UNE-P). As noted earlier, many incumbents are attempting to restrict or limit the CLECs' ability to provide service to end-use customers through UNE-P by seeking changes at the federal level. Because Texas CLECs rely heavily on the use of UNE-P as an entry mechanism, such a decision could have a widespread effect on the competitive market for local telecommunications services in Texas. As is also shown in Figure 9, CLECs serve 30% of their customers using some or all of their own facilities. This includes CLEC-owned and unbundled network element loop (UNE-L) entry strategies.

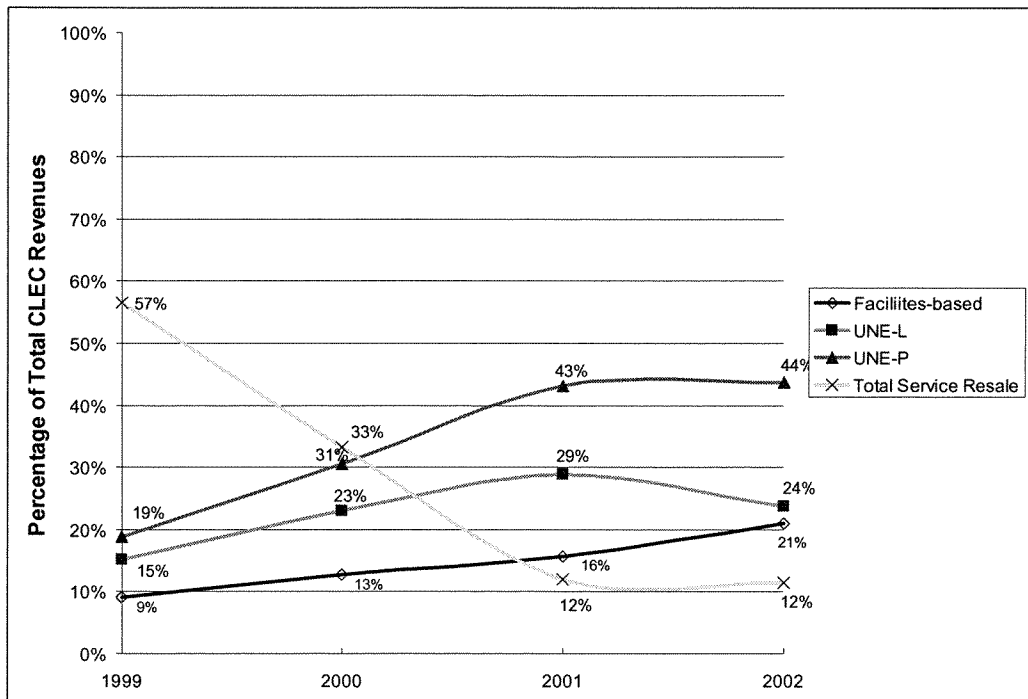
Figure 9 — CLEC Lines by Entry Strategy in Texas, as of June 2002



SOURCE: Texas PUC 2003 Scope of Competition Data Responses

Revenues from total service resale (TSR) have sharply dropped since 1999, and seem to have bottomed out. Revenues reported from the use of unbundled network elements (UNEs) in combination with the CLEC's own switch (known as UNE-L) have also recently shown a downward trend. In contrast, revenues from providing service entirely through the CLEC's own facilities (facilities-based) have steadily increased in the past six months. CLECs using the UNE-P reported revenues that almost doubled between 2000 and 2001, and have since flattened out.

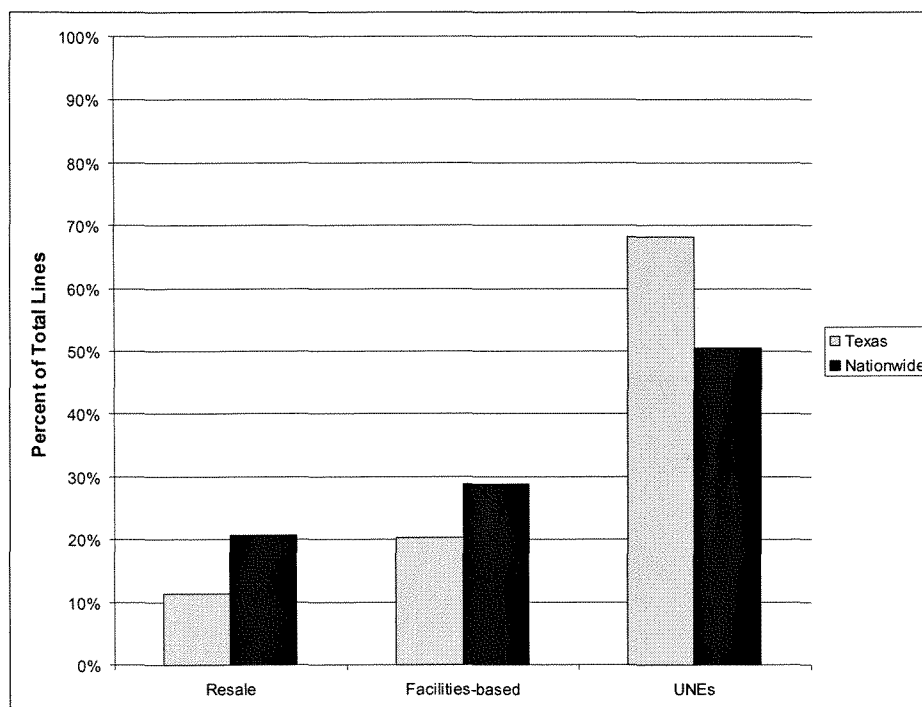
Figure 10 — Revenue by CLEC Entry Strategy in Texas



SOURCE: Texas PUC 2003 Scope of Competition Data Responses. The June 2002 revenue as reported has been doubled to estimate year-end 2002 revenues.

As reflected in Figure 11, the CLECs in the Texas market rely on UNEs more than CLECs in other States. Texas is second only to New York in the number of lines served via UNEs.

Figure 11 — Texas CLEC Entry Strategy vs. Nationwide



SOURCE: June 2002 national data reported in *Local Telephone Competition Reports*, FCC (Dec. 2002), compared with June 2002 Texas data from the Texas PUC 2003 Scope of Competition Data Responses.

b. CLEC Geographic Markets

Overall, CLECs serve Texas customers in all areas of the State, although CLECs serve more customers in urban than in rural areas in absolute terms.

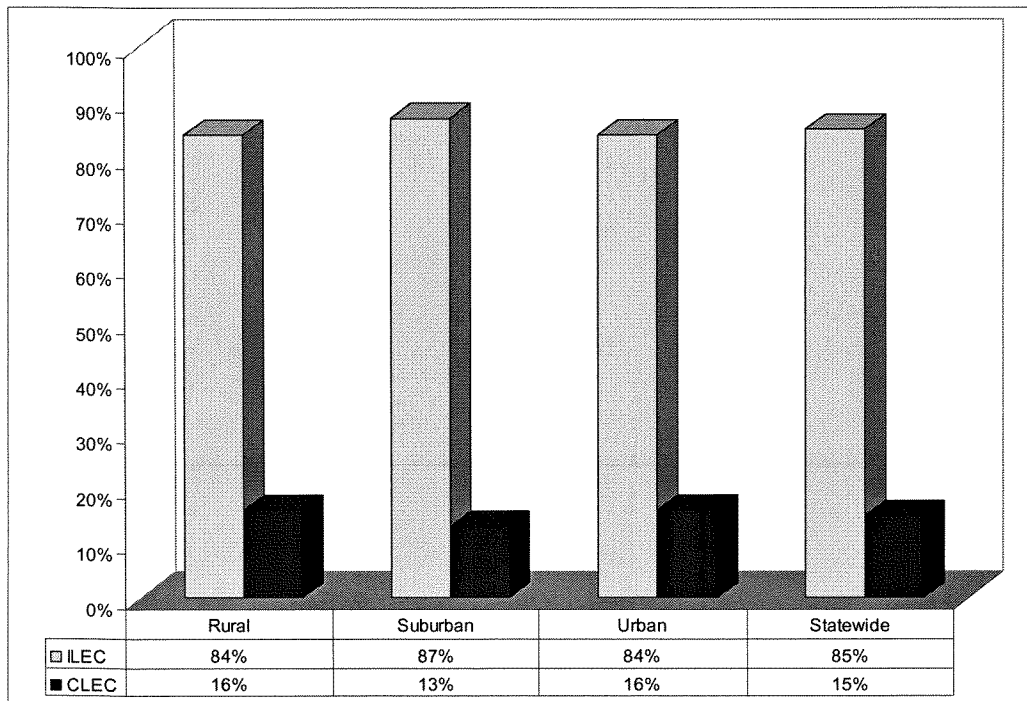
Table 5 — Total Access Lines by Geography

| | Rural | Suburban | Urban | Total |
|--------------|-----------|-----------|-----------|------------|
| ILEC | 2,918,097 | 2,287,050 | 6,145,547 | 11,350,694 |
| CLEC | 564,413 | 330,484 | 1,182,759 | 2,077,656 |
| Total | 3,482,510 | 2,617,534 | 7,328,306 | 13,429,159 |

SOURCE: Texas PUC 2003 Scope of Competition Data Responses. The CLEC line total excludes 809 access lines for which exchange information was not provided by the carrier.

On a percentage basis, CLECs now serve the same percentage of the access lines in rural areas as in urban areas, as shown by Figure 12. CLECs actually serve a smaller percentage of the access lines in suburban areas than they do in urban or rural areas.

Figure 12 — ILEC versus CLEC Lines in Texas by Geography as of June 30, 2002



SOURCE: Texas PUC 2003 Scope of Competition Data Responses

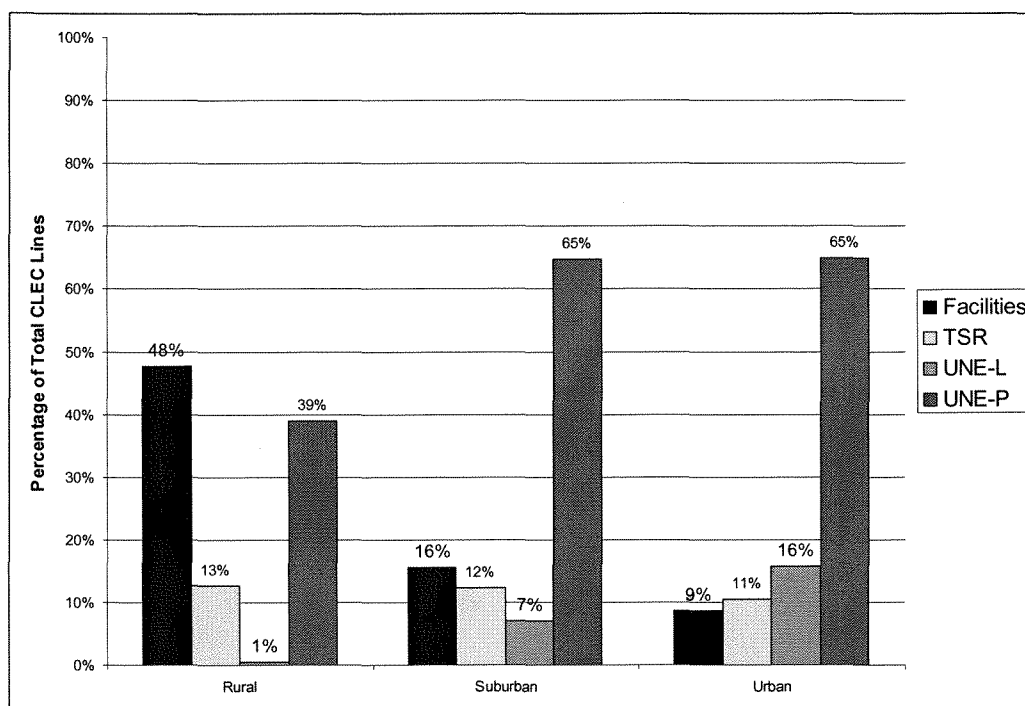
While many CLECs continue to focus their competitive efforts in urban areas, a few niche players have remained strong by serving suburban or rural customers. Sage Telecom, for example, serves rural residential and business customers exclusively through UNE-P, without using any of its own facilities.⁵³ Using market entry strategies such as UNE-P, UNE-L, TSR, and facility deployment, CLECs have acquired some level of penetration in virtually all areas of the State.⁵⁴

⁵³ *Petition of MCI Metro Access Transmission Services, LLC, Sage Telecom, Inc., Texas UNE Platform Coalition, McLeod USA Telecommunications Services, Inc. and AT&T Communications of Texas, L.P. for Arbitration with Southwestern Bell Telephone Company Under the Telecommunications Act of 1996*, Docket No. 24542, Direct Testimony of Gary P. Nuttall at 7 (Dec. 7, 2001).

⁵⁴ See maps contained in Appendices J-M.

As shown in Figure 13, of June 2002, a higher percentage of rural than urban or suburban customers were served by CLECs using the CLEC's own facilities.⁵⁵

Figure 13 — CLEC Lines by Geography and by Entry Strategy in Texas, as of June 2002



SOURCE: Texas PUC 2003 Scope of Competition Data Responses

As shown in Table 6, CLECs serve far fewer lines in suburban areas than in rural or urban, and more than twice as many customers by their own facilities in rural than in urban areas.

Table 6 — CLEC Lines by Entry Strategy and Geography in Texas

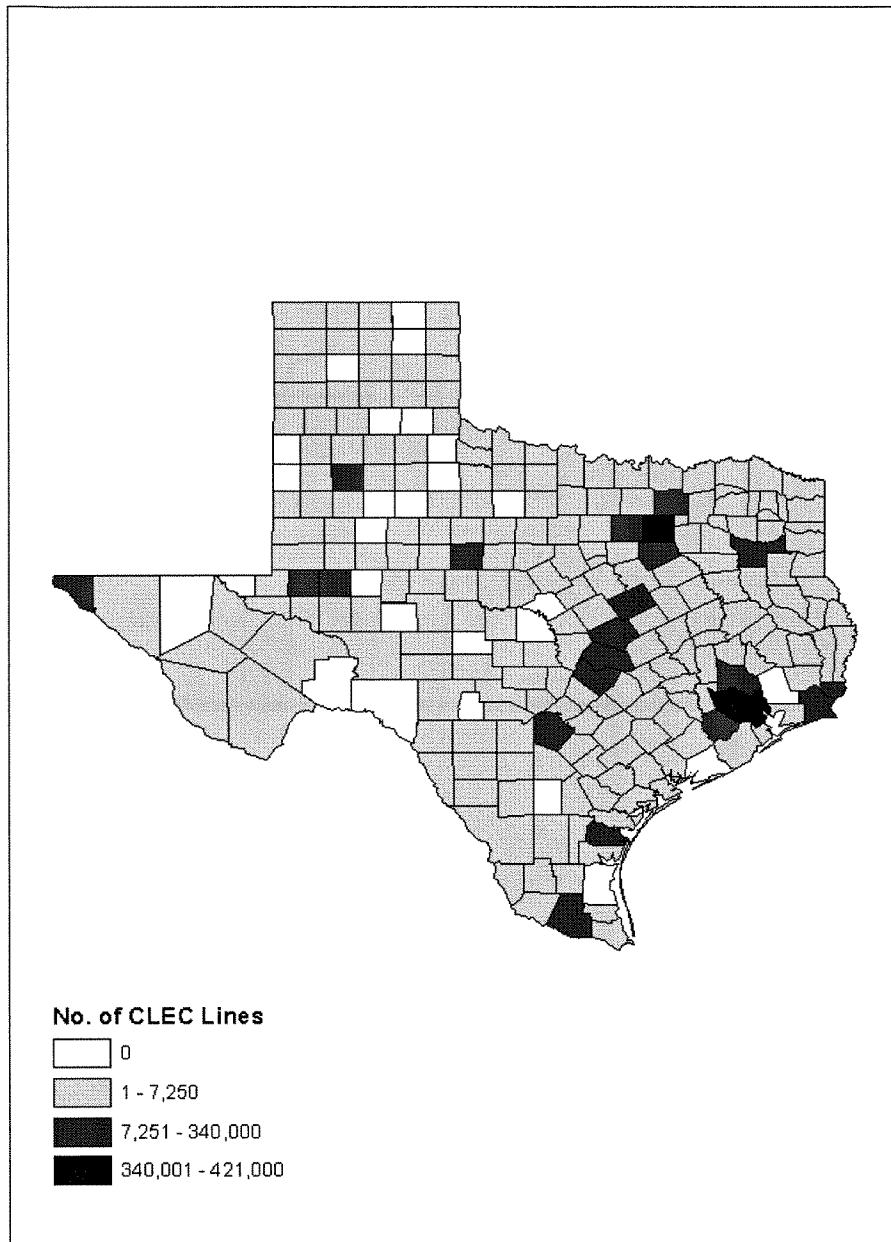
| | Facilities | TSR | UNE-L | UNE-P | Total |
|----------|------------|---------|---------|---------|-----------|
| Rural | 269,300 | 71,684 | 3,036 | 220,393 | 564,413 |
| Suburban | 51,681 | 40,877 | 23,615 | 214,311 | 330,484 |
| Urban | 102,741 | 124,401 | 186,345 | 769,272 | 1,182,759 |

SOURCE: Texas PUC 2003 Scope of Competition Data Responses

As illustrated by Figure 14, CLECs have obtained more lines in urban areas, primarily in downtown and other business districts.⁵⁶ This could be attributed to high investment costs and small customer bases in rural areas, resulting in smaller profit margins.

⁵⁵ Appendix A, Research Methodology, contains the definition of rural, suburban, and urban that was used to collect data for the 2003 Scope of Competition Report.

⁵⁶ See also maps contained in Appendices J-M.

Figure 14 — Total Number of CLEC Lines by County, as of June 2002

SOURCE: Texas PUC 2003 Scope of Competition Data Responses

c. CLEC Business and Residential Customers

As of June 2002, CLECs served more residential than business lines in all markets throughout the State. However, it is important to note that the statewide ratio of residential versus non-residential lines is 1.75 to 1, whereas the CLEC ratio is 1.5 residential lines to 1 non-residential line.

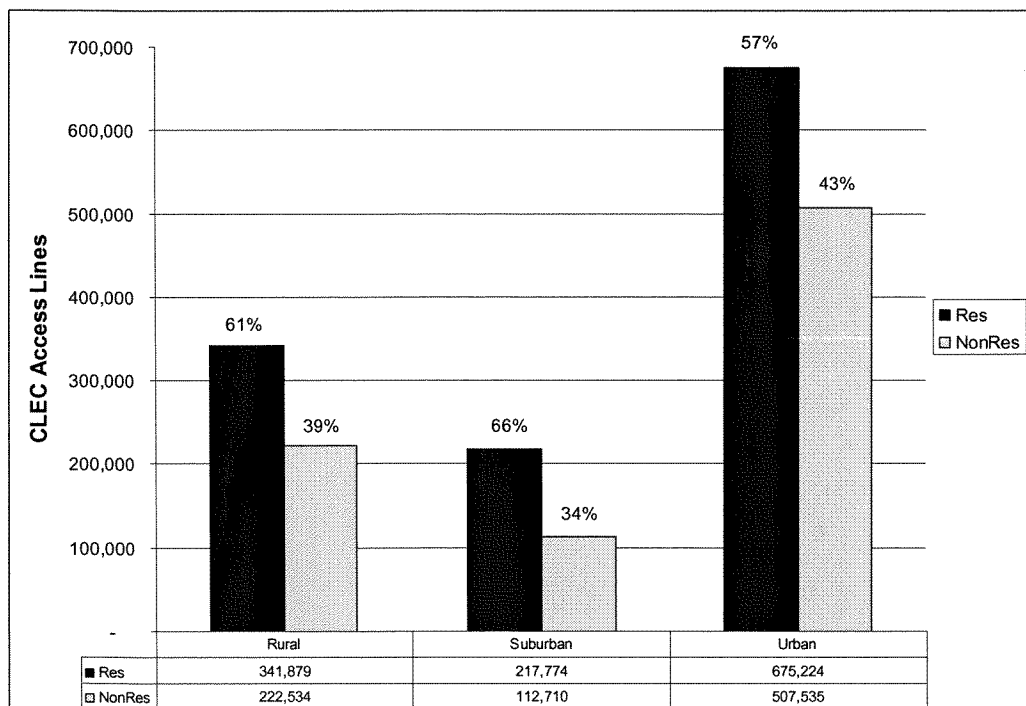
Table 7 — Total ILEC and CLEC Residential and Non-Residential Lines in Texas, as of June 2002

| | ILEC | CLEC | TOTAL |
|------------------------|-----------|-----------|------------------|
| Residential | 7,319,140 | 1,235,214 | 8,554,354 |
| Non-Residential | 4,031,554 | 843,251 | 4,874,805 |

SOURCE: Texas PUC 2003 Scope of Competition Data Responses, excludes ILEC-reported wholesale lines.

A further breakdown of the CLEC residential and non-residential lines in Texas reveals that in all three zones of the State (rural, suburban, and urban),⁵⁷ CLECs have more residential lines than non-residential.

Figure 15 — CLEC Lines by Geography and Type of Customer in Texas

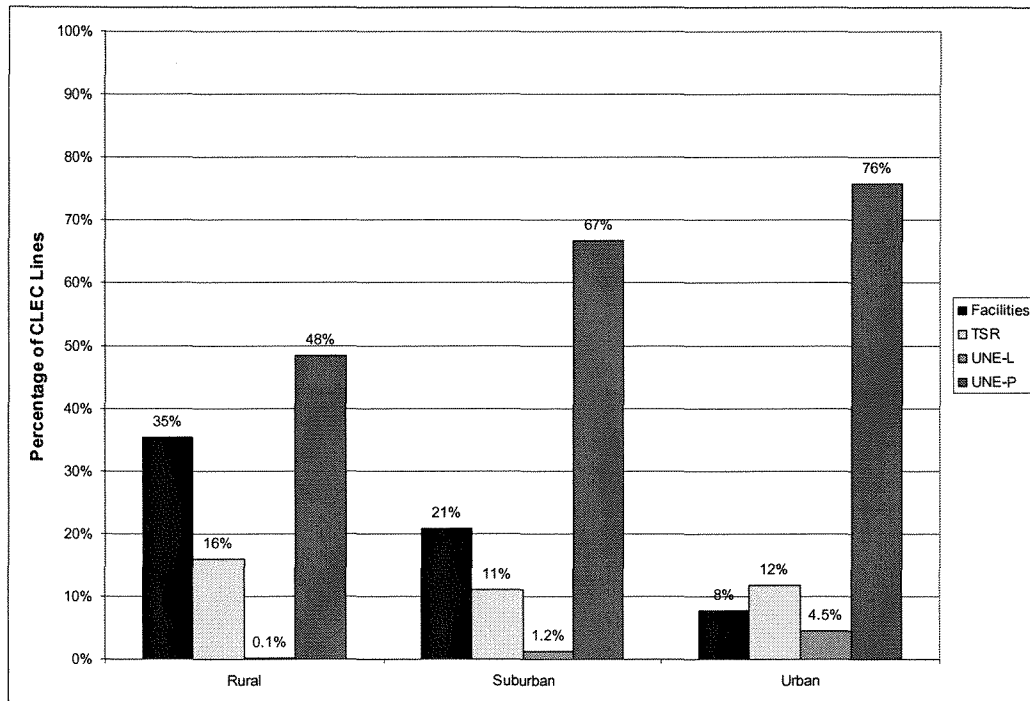


SOURCE: Texas PUC 2003 Scope of Competition Data Responses. Excludes ILEC-reported wholesale lines, and 809 CLEC access lines for which exchange information was not provided.

⁵⁷ Appendix A, Research Methodology, contains the definition of rural, suburban, and urban that was used to collect data for the 2003 Scope of Competition Report.

UNE-P remains the entry strategy of choice for CLECs to serve residential customers in any of the three zones.

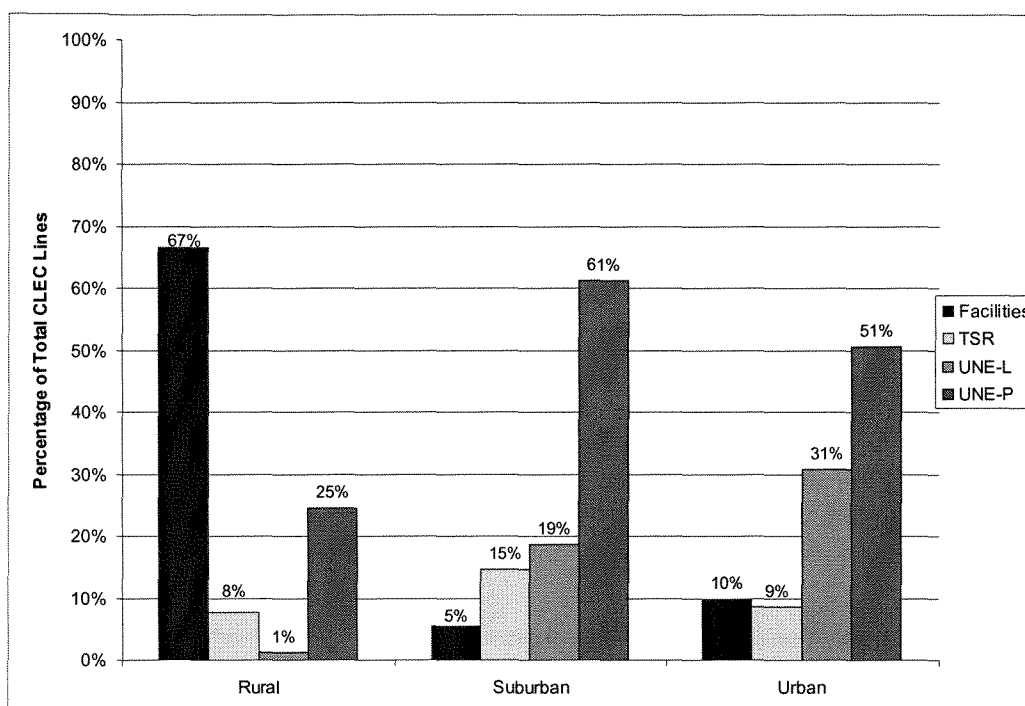
Figure 16 — CLEC Residential Lines by Entry Strategy in Texas



SOURCE: Texas PUC 2003 Scope of Competition Data Responses

However, as shown in Figures 17 and 18, CLECs have made deeper inroads into the non-residential market. CLECs serve three times as many non-residential customers in rural areas (148,190 lines) than in urban areas (49,899 lines) using their own facilities to provide service.

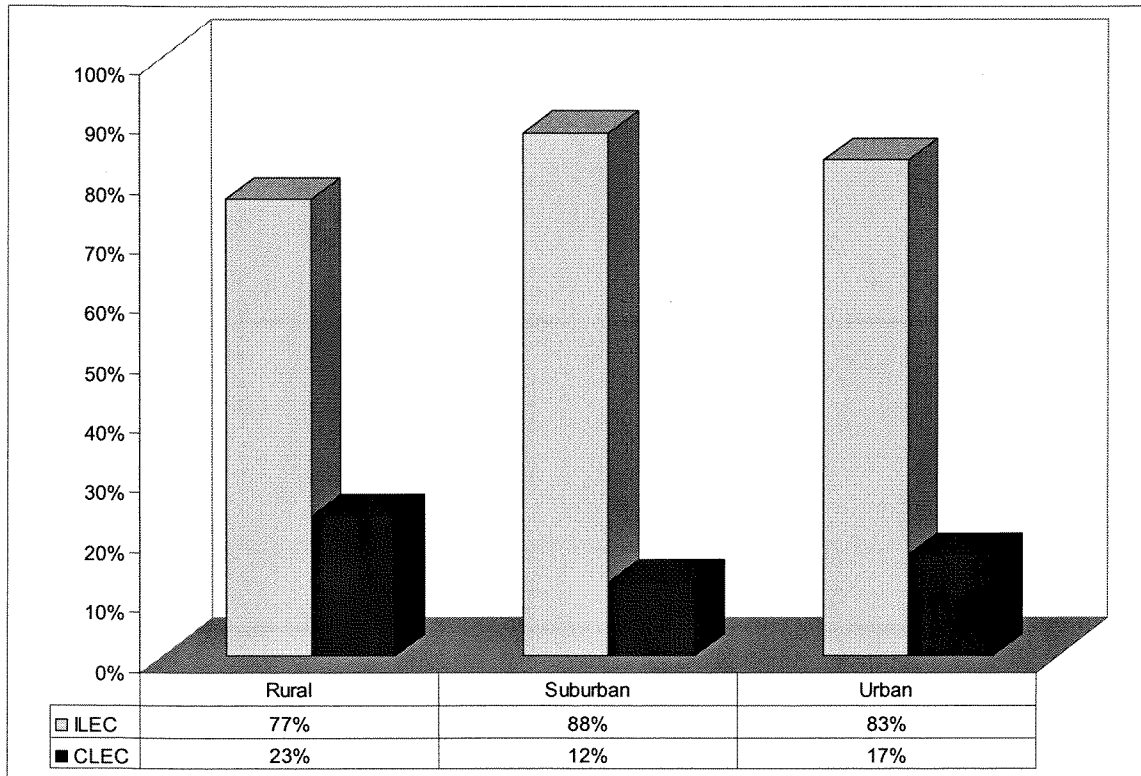
Figure 17 — CLEC Non-Residential Lines by Entry Strategy in Texas



SOURCE: Texas PUC 2003 Scope of Competition Data Responses

In addition, CLECs serve 23% of the business customers in rural areas of the State, compared to 17% market penetration in urban areas, and just 12% in suburban areas.

Figure 18—LEC Non-Residential Lines in Texas by Geography as of June 30, 2002



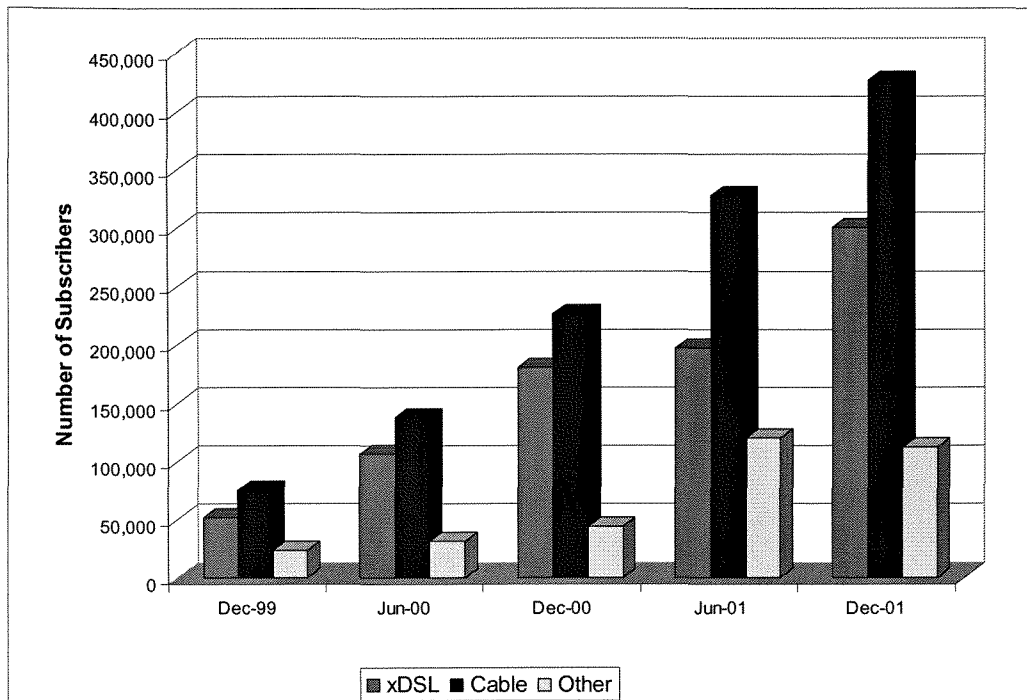
| | Rural | Suburban | Urban |
|-------------|---------|----------|-----------|
| ILEC | 726,338 | 796,921 | 2,495,478 |
| CLEC | 222,534 | 112,710 | 507,535 |

SOURCE: Texas PUC Scope of Competition Data Responses. Excludes ILEC-reported wholesale lines, and 809 CLEC access lines for which exchange information was not provided.

B. Broadband Market in Texas

Since the *2001 Scope Report*, broadband subscribership in Texas has grown from 152,000 customers in December 1999 to over one million customers as of June 2002.

Figure 19 — Broadband Subscribers in Texas



SOURCE: *High Speed Services for Internet Access*, FCC (Dec. 2000, August 2001, Feb. and July 2002).

FCC data reveals that of the high-speed lines in Texas, 89% were for residential and small business use; the remaining 11% were lines in service connecting to medium and large business, institutional, or government end-user customers.⁵⁸

With respect to technology deployed in the last mile, 55% of high-speed services were delivered over coaxial cable; 35% were delivered over asymmetric digital subscriber line (ADSL); and 10% included wireline technologies other than asymmetric digital subscriber line (ADSL), optical fiber to the subscriber's premises, satellite, and terrestrial, fixed wireless systems.⁵⁹

⁵⁸ Federal Communications Commission, Industry Analysis and Technology Division, *High-Speed Services for Internet Access, Status as of June 30, 2002*, WIRELINE COMPETITION BUREAU, December 2002. Available online at: www.fcc.gov/wcb/iatd/comp.html.

⁵⁹ Federal Communications Commission, Industry Analysis and Technology Division, *High-Speed Services for Internet Access, Status as of July 30, 2002*, WIRELINE COMPETITION BUREAU, December 2002. Available online at: www.fcc.gov/wcb/iatd/comp.html.

With respect to other States, Texas was ranked fourth for the number of high-speed lines. For the period 1999 to 2002, Texas's broadband growth rate exceeded the national average and that of many other large States.⁶⁰

Table 8 — Broadband Subscribers in Texas Compared to Other States

| STATE | <u>1999</u> TOTAL | <u>JUNE 2000</u> TOTAL | <u>DEC. 2000</u> TOTAL | <u>JUNE 2001</u> TOTAL | <u>DEC. 2001</u> TOTAL | <u>JUNE 2002</u> TOTAL | % CHANGE 1999 TO 2002 |
|------------------|----------------------|---------------------------|---------------------------|---------------------------|---------------------------|---------------------------|--------------------------------|
| Texas | 152,518 | 267,087 | 522,538 | 646,839 | 840,665 | 1,050,511 | 589 |
| California | 547,179 | 910,006 | 1,386,625 | 1,705,814 | 2,041,276 | 2,598,491 | 375 |
| Massachusetts | 114,116 | 185,365 | 289,447 | 357,256 | 505,819 | 583,627 | 411 |
| New York | 186,504 | 342,743 | 603,487 | 893,032 | 1,199,159 | 1,460,894 | 683 |
| North Carolina | 57,881 | 81,998 | 136,703 | 205,616 | 357,906 | 461,736 | 698 |
| Pennsylvania | 71,926 | 79,892 | 176,670 | 263,236 | 376,439 | 516,488 | 618 |
| Nationwide Total | 2,754,286 | 4,367,434 | 7,069,874 | 9,616,341 | 12,792,812 | 16,202,540 | 488 |

SOURCE: *High Speed Services for Internet Access*, FCC (December 2002).

Broadband providers continue to offer new products and services to attract additional customers. In August 2002, SBC Communications released plans to roll out additional lower-speed, lower-priced digital subscriber line (DSL) options in certain markets in Texas in an attempt to compete with the cable modem market.⁶¹ For example, in a co-branding arrangement with Yahoo, SBC rolled out a slower, less expensive DSL service for \$42.95 per month in September 2002.⁶²

Cable continues to capture market share, and with the addition of video-on-demand platforms, the cable industry is expected to continue to perform well.⁶³

As reflected in Figures 20 and 21 below, in general, there are more broadband providers in counties with higher population densities. However, Figure 21 demonstrates that while several counties in Texas lack cable or DSL providers altogether, a few somewhat sparsely populated counties of the State actually are served by one or more providers.

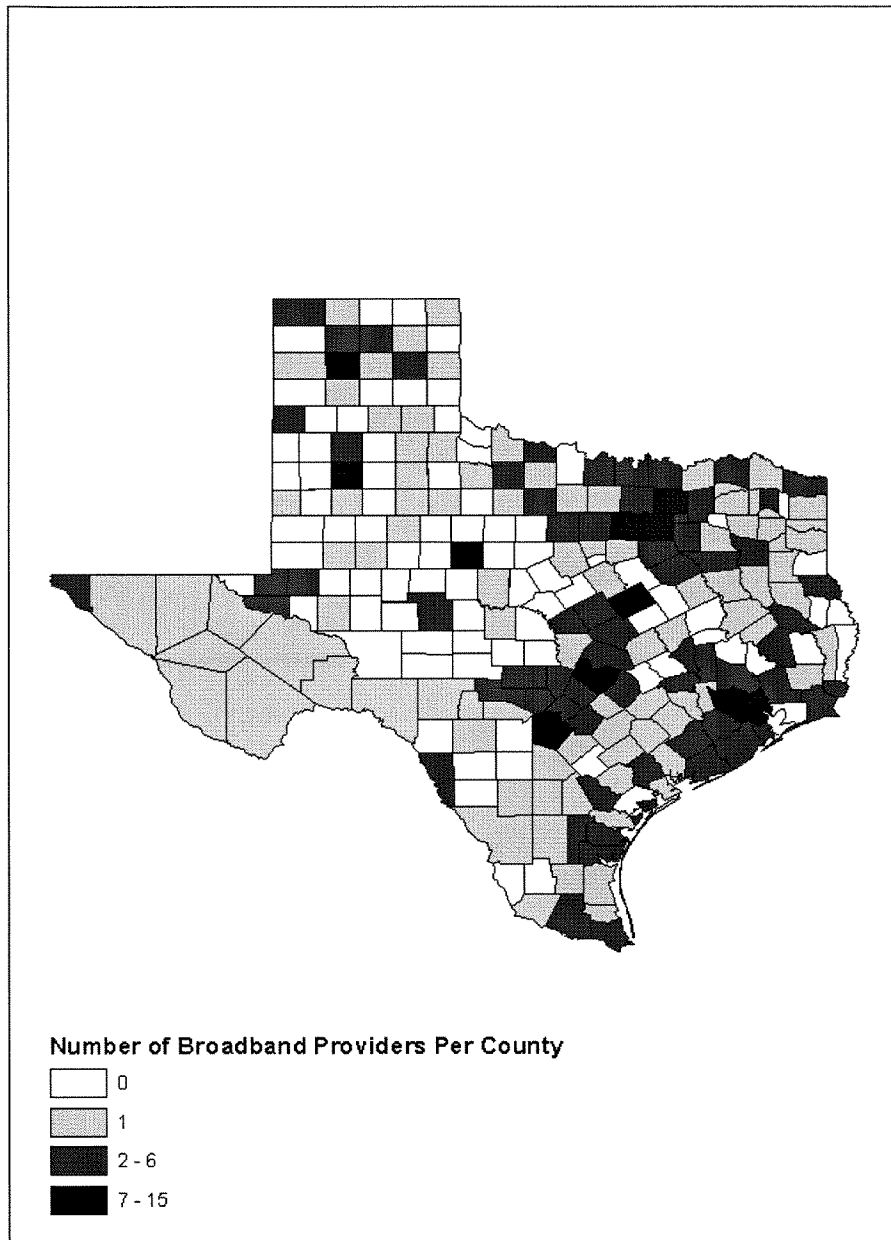
⁶⁰ *Id.*

⁶¹ Andrea Ahles, *Quick studies*, FORT WORTH STAR-TELEGRAM, August 22, 2002, p. C1.

⁶² Andrea Ahles, *SBC Communications offers co-branded broadband service*, STAR-TELEGRAM at 2C (Sept. 19, 2002).

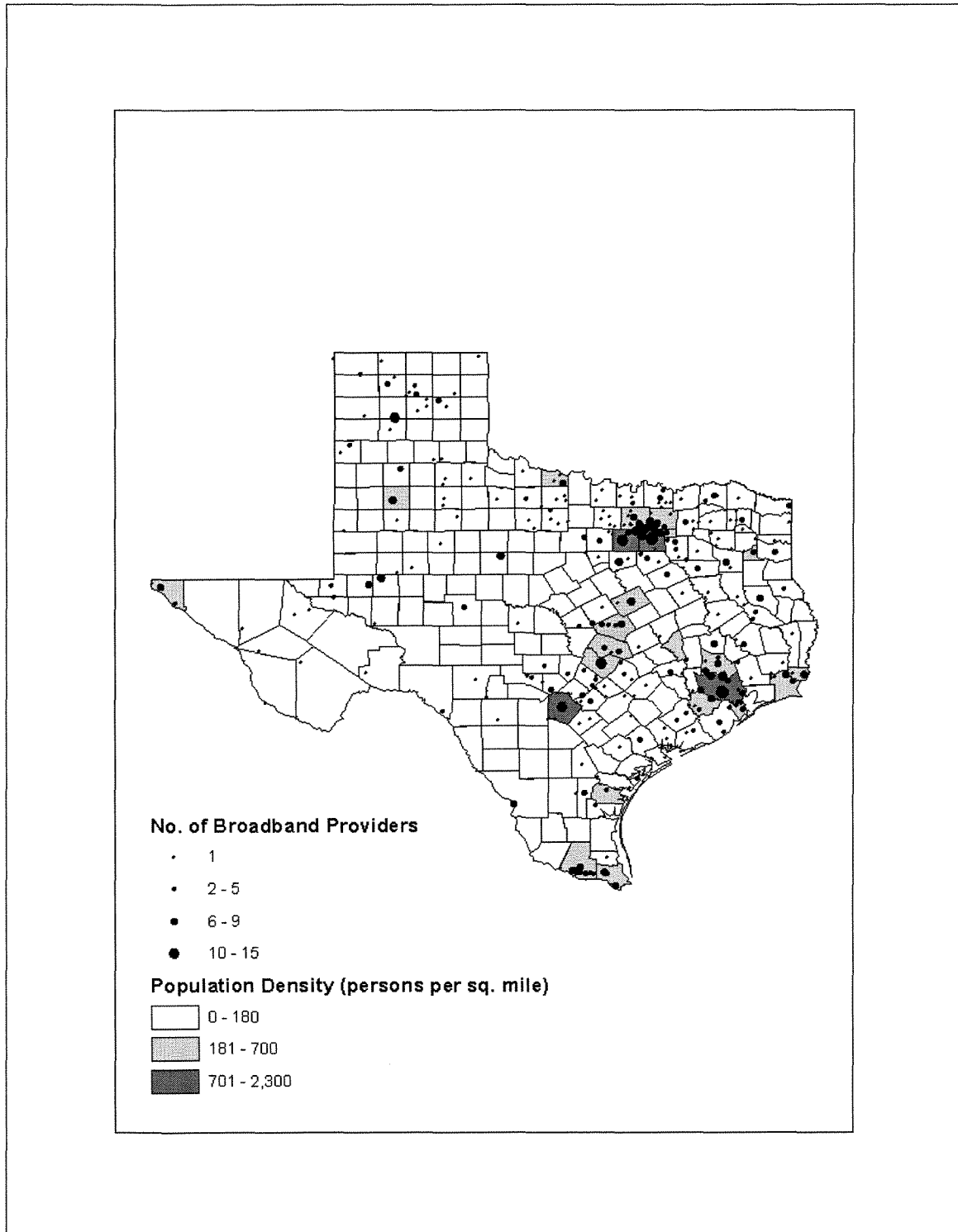
⁶³ Roben Farzad, *Telecom-Mess Survivors*, FWST (May 5, 2002); Dan Sweeney, *Cable's Plumb Position*, AMERICA'S NETWORK at 32 (July 1, 2002).

Figure 20 — Number of Broadband Providers per County as of June 2002



SOURCE: Texas PUC 2003 Scope of Competition Data Responses

Figure 21 — Number of Broadband Providers by Population Density of County

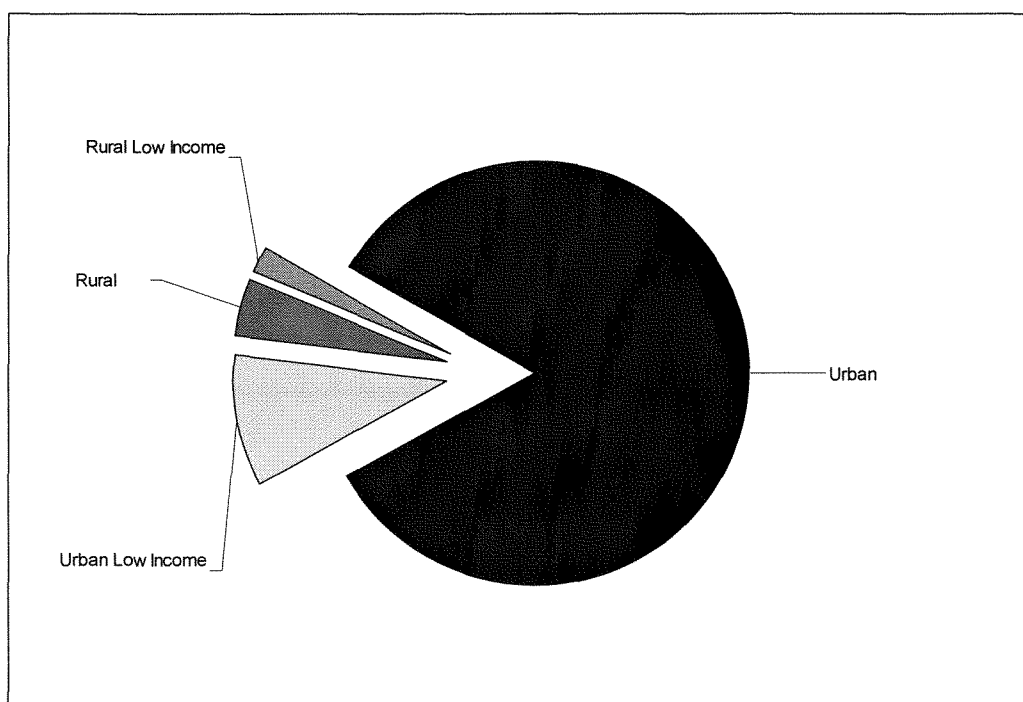


SOURCE: Texas PUC 2003 Scope of Competition Data Responses

SBC offers a DSL product—referred to as Project Pronto—that it launched in the Fall of 1999.⁶⁴ By placing remote terminals further into residential neighborhoods, SBC is able to overcome distance limitations to bring DSL service within the reach of the vast majority of its customers. SBC's goal at the outset was to have DSL available to 80% of its customer base by 2002. By October 2001, SBC had scaled that number back to 58% and was announcing a further slowdown in towns with lower population densities.⁶⁵ This slowdown was intended to cut capital expenditures by \$1 billion.

As shown in Figure 22, 94% of SBC's DSL deployment in Texas is in urban areas, including low-income urban areas.

Figure 22 — Urban vs. Rural SBC Wire Centers with DSL Deployment, 4th Quarter 2001



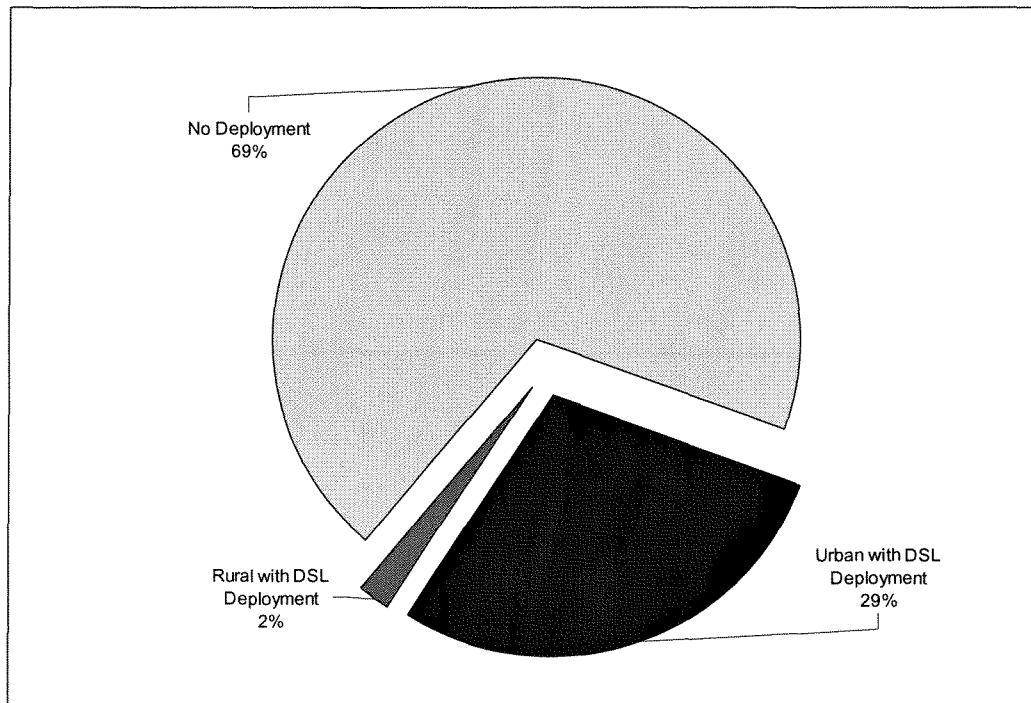
SOURCE: SBC/Ameritech Merger xDSL Deployment,
http://www.fcc.gov/wcb/mcot/SBC_AIT/xDSL_deployment (October 30, 2002)

⁶⁴ Karen Brown, *SBC Takes Pronto Out Of DSL Buildout Pace*, BROADBAND WEEK, October 29, 2001.

⁶⁵ *Id.*

Figure 23 shows that as of the fourth quarter of 2001, 69% of SBC wire centers in Texas had no deployment of DSL.

Figure 23 — xDSL Deployment in SBC Wire Centers, 4th Quarter 2001



SOURCE: SBC/Ameritech Merger xDSL Deployment,
http://www.fcc.gov/wcb/mcot/SBC_AIT/xDSL_deployment (October 30, 2002)

SBC has argued that while DSL could be one of its key growth enterprises, it is unwilling to invest further substantial capital in it under current regulations.⁶⁶ According to SBC, on a nationwide scale, although 70% of high-speed internet access consumers use a cable modem and only 30% use DSL, the cable industry remains virtually unregulated while SBC faces what it calls “pervasive regulation.”⁶⁷

⁶⁶ Vikas Bajaj, *SBC says industry policies need to change*, DALLAS MORNING NEWS, July 9, 2002, p. D1.

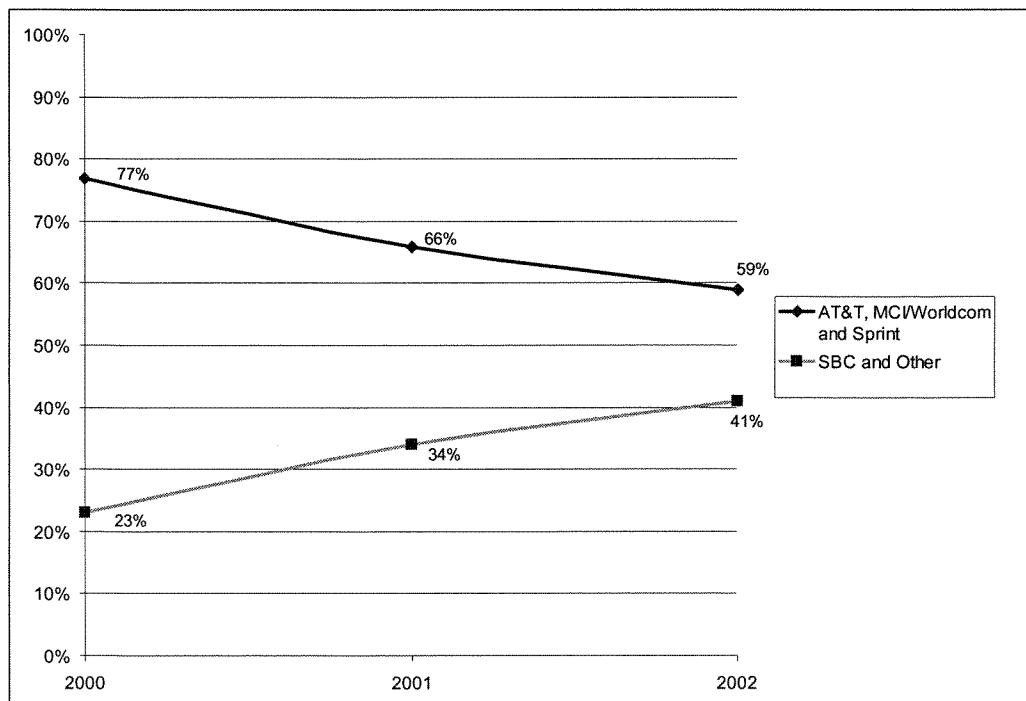
⁶⁷ *Id.*

C. Long-Distance Market in Texas

1. Market Share

Since entering the interLATA telephone markets in 2000, SBC's share of the Texas long-distance market has grown. Comparing the long-distance market share (measured in minutes-of-use) jointly held by AT&T, MCI/WorldCom, and Sprint with that of SBC and other carriers, the market share of SBC and others grew from 23% in 2000, to 34% in 2001, and reached 41% in 2002.⁶⁸

Figure 24 — Long-distance Market Share Over Time



SOURCE: Texas PUC 2003 Scope of Competition Data Responses. The other category includes facilities-based IXC's, such as Williams Communications and Broadwing, Inc., as well as resellers.

Increased long-distance competition has resulted in substantial savings for customers. A recent analysis of Texas long-distance rates indicated that Southwestern Bell's entry into the long-distance market lowered peak long-distance prices by 11%, weekday off-peak prices by 18%, and weekend off-peak prices by 9%.⁶⁹ The same study found that the average Texas consumer would have paid \$17.52 for long-distance prior to SWBT's entry and would have paid \$15.72 in the post entry period, implying a savings of \$1.80 or 10.3%.

⁶⁸ Texas PUC 2003 Scope of Competition Data Request.

⁶⁹ Hausman, Leonard, and Sidak, Does Bell Company Entry Into Long Distance Telecommunications Benefit Consumers?, 70 ANTITRUST L.J. (2002) at 463.

2. Long-Distance and Wireless Comparison

As discussed in Chapter II of this Report, the wireless market is growing while the long-distance market seems to be shrinking. Table 9 demonstrates that there is some correlation between the growth in the wireless market and the decline in the long-distance market. This comparison was done by comparing the number of mobile subscribers in Texas, which has nearly doubled in the last two years, with the number of switched access minutes-of-use in Texas, which increased slightly between 1999 and 2000 and has subsequently fallen off by about 3%. Table 9 also includes the number of basic dial tone lines, which expanded in 2000 from 1999 levels, but fell in 2001.

Table 9 — Comparison of Wireline and Wireless in Texas

| | 1999 | 2000 | 2001 |
|---|----------------|----------------|----------------|
| Mobile Wireless Subscribers | 5,792,453 | 7,548,537 | 9,062,064 |
| Long-distance (Switched Access) Minutes of Use | 11,397,493,545 | 11,495,969,512 | 11,137,023,457 |
| Total Basic Dialtone Lines | 13,188,047 | 13,750,684 | 13,531,474 |

SOURCES: *Local Telephone Competition Reports*, FCC (Aug. 2000, May 2001, July 2002), Texas PUC 2003 Scope of Competition Data Responses.